Taking Into Account Control Under Denial of Benefits Clauses

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INTRODUCTION

Denial of benefits clauses play an increasingly important role in investment law and investment arbitration. Originally developed in the U.S. treaty practice, these clauses "allow a party to deny the benefits of the treaty to certain investors that lack a sufficient connection to the BIT party in which they are incorporated."[1] These clauses generally have two functions: either denying treaty protection to investors whose home State does not maintain diplomatic relations with the host State,[2] or preventing third country nationals who own or control the investor from gaining access to treaty protection when they would otherwise not benefit from such protection due to their nationality.

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[1] *See* KENNETH J. VANDEVELDE, U.S. INTERNATIONAL INVESTMENT AGREEMENTS 105 (Oxford University Press, 2009).

[2] At the time of writing, no case law has developed on these types of denial of benefits clauses.

The varied wording of denial of benefits clauses, the differences among international investment agreements ("IIA"), and the diverse factual circumstances in which such clauses have been relied upon have given rise to a rich arbitral case law on the topic. Section I of the present contribution examines how the particular wording of a denial of benefits clause reveals the policy underlying its inclusion in an IIA. Section II analyses arbitral tribunals' interpretation of the conditions generally included in denial of benefits clauses. Finally, Section III considers two specific issues concerning the operation of denial of benefits clauses, namely whether a denial of benefits affects an arbitral tribunal's jurisdiction or the substantive protections under the treaty, and whether a host State may deny treaty benefits after an investor has submitted a claim to arbitration.

I. DENIAL OF BENEFITS: WHAT LANGUAGE FOR WHAT POLICY?

The inclusion of a denial of benefits clause in an IIA reflects a choice by the State parties. The particular wording of denial of benefits clauses varies from one treaty to another, and thus reveals the specific policy espoused by State parties when agreeing to include it. The scope and effect of a denial of benefits clause will further depend on the clause's interaction with other provisions of an IIA.

Denial of benefits clauses originated in treaties of Friendship, Commerce and Navigation ("FCN") signed by the United States after 1945.[3] FCN treaties guaranteed companies of

[3] *See, e.g.*, Treaty of Friendship, Commerce and Navigation between the United States of America and China (signed 4 Nov. 1946, entered into force 30 Nov. 1948), Art. XXVI(5), 25 U.N.T.S. 69; Treaty of Amity and Economic Relations between the United States of America and Ethiopia (signed 7 Sept. 1951, entered into force 8 Oct. 1953), Art. VII(3), 206 U.N.T.S. 41. The full

one State Party certain rights in the territory of the other State Party, namely the right to be recognized as an entity having legal personality and the right to access State courts. As one leading commentator on U.S. treaty practice explains, because FCNs concluded during this period ascribed nationality to a company according to its place of incorporation, regardless of its principal place of business, denial of benefits clauses prevented investors who were not nationals of one of the two State Parties from incorporating under their laws and benefitting from treaty protection. They thereby functioned to exclude so-called "free rider" investors who were seeking to enjoy the benefits of the FCN, but whose home State had not incurred any reciprocal obligations towards the FCN parties.[4]

The United States continued to include denial of benefits clauses in its bilateral investment treaties ("BIT") program, beginning with the 1983 U.S. Model BIT.[5] Consistent with this policy, Article 17 of the 2012 U.S. Model BIT sets forth two distinct circumstances in which a State Party "may deny the benefits" of the treaty to an investor: where the denying State does

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text of these provisions is set out in Annex A to the present article. *See also* KENNETH J. VANDEVELDE, THE FIRST BILATERAL INVESTMENT TREATIES – U.S. POSTWAR FRIENDSHIP, COMMERCE AND NAVIGATION TREATIES 394 (Oxford University Press, 2017) (quoting the U.S. State Department in 1953 that "the denial of benefits provision states merely a latent power which each Party reserves to itself with respect to companies of the other, rather than a basic self-operative rule of the treaty. It allows each Party, to the extent that it may so choose, to 'pierce the corporate veil,' but does not require that this be done. The reservation is not expected normally to be invoked or used by either Party in a manner which will impede the companies of the other Party from freely going about their business; but it is a precautionary stipulation included mainly to allow a Party in case of need to prevent third-country interests from getting a 'free ride' through the medium of a dummy or 'front' corporation chartered under the laws of the other Party.").

[4] VANDEVELDE, *supra* note 1, at 148.

[5] *Id.,* at 150.

not maintain diplomatic relations with the investor's home State, and in situations where an investment is made by a mailbox company.[6]

Thus, pursuant to Article 17(1) of the 2012 U.S. Model BIT, a State Party may deny benefits to an investor "of the other Party that is an enterprise of such other Party and to investments of that investor" if two cumulative conditions are met. First, nationals of a non-Party must "own or control the enterprise," and second, the denying State must either "not maintain diplomatic relations with the non-Party" or apply economic sanctions on the non-Party. For example, this provision would allow the United States to deny the benefits of a treaty to a company that is incorporated in the territory of the other State party but is owned or controlled by nationals of Cuba, as the United States maintains a comprehensive economic embargo against that country.[7]

Article 17(2) of the 2012 U.S. Model BIT in turn allows a State party to deny benefits to an investor of the other State Party if two cumulative conditions are met. First, the investor must have "no substantial business activities" in its country of incorporation. Second, "persons of a non-Party, or of the denying Party" must "own or control the enterprise." The second condition under Article 17(2) is noteworthy: in addition to allowing for denial of benefits to investors controlled by nationals of a third State, Article 17(2) provides that benefits may be denied to investors

[6] U.S. 2012 Model Bilateral Investment Treaty, Art. 17, U.S. Department of State's website. The full text of this provision is set out in Annex A to the present article. On the U.S. policy of excluding "free rider" investors, see Section III.B below on *Pac Rim Cayman v. El Salvador* (ICSID Case No. ARB/09/12), Decision on the Respondent's Jurisdictional Objections (V.V. Veeder, President, G.S. Tawil, B. Stern), 1 June 2012, italaw website.

[7] At the time of writing, new regulatory amendments are expected to be adopted by the U.S. Government following additional economic restrictions announced by President Donald Trump.

owned or controlled by persons having the nationality of the host State itself. This wording was first introduced in the 2004 U.S. Model BIT[8] and reflects a specific policy: the provision aims not only to exclude from a treaty's protection third State interests behind a mailbox company, given that such States have not undertaken any commitment vis-à-vis the Parties to the IIA, but to also exclude host State interests behind a mailbox company so as to deny protection to ultimate domestic investors.

Other bilateral[9] and multilateral IIAs have followed the same policies, that of excluding from a treaty's protection certain nationals, either because their home State has not undertaken any reciprocal obligations towards the State parties or because their home State is the host State itself, or denying protection to nationals of a State with which diplomatic relations have been discontinued or that is the object of sanctions. Each of these policies, however, must be stated in express and specific language. In other words, an IIA that excludes from its scope of protection

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8 Article 17(2) of the 2004 U.S. Model BIT provides: "A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and *persons of a non-Party, or of the denying Party*, own or control the enterprise." (emphasis added). Provisions in earlier versions of the U.S. Model BIT allowed for denial of benefits where a company had no substantial business activities in its country of incorporation and was owned or controlled by persons of a non-Party, but not by persons of the denying Party.

9 *See, e.g.,* Agreement for the Promotion and Protection of Investments between the Republic of Colombia and the Republic of India, Art. 11(2) (signed 10 Nov. 2009, entered into force 3 July 2013), which provides: "A Contracting Party may deny the benefits of this Agreement to an investor of the other Contracting Party that is a company of such other Party and to investments of that investor if the company has no substantial business activities in the territory of the other Contracting Party and persons of a non-Party, or of the denying Contracting Party, own or control the company."

third State nationals is not deemed, absent express language, to also exclude nationals of the host State.[10]

For example, the denial of benefits clause found at Article 1113(2) of the North American Free Trade Agreement ("NAFTA")[11] provides that a NAFTA Party "may deny the benefits of" NAFTA Chapter 11 under conditions similar to those enumerated under Article 17(2) of the U.S. Model BIT. However, in contrast to Article 17(2) of the 2012 U.S. Model BIT, under Article 1113(2) of NAFTA, which was adopted before the expansion achieved in the 2004 U.S. Model BIT, benefits may only be denied if "investors of a non-Party own or control the enterprise."

The NAFTA drafters have set further conditions on any denial of benefits. Article 1113(2) provides that a Party seeking to deny the benefits of Chapter 11 must follow the requirements of prior notification under Article 1803 and consultation under Article 2006.[12] These requirements contemplate the early inter-State consultation concerning a denial of benefits by a NAFTA

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[10] On this question, see Hulley Enterprises Limited (Cyprus) v. Russian Federation (UNCITRAL (PCA Case No. AA 226)), Interim Award on Jurisdiction and Admissibility, 30 Nov. 2009, ¶¶ 537, 543–45; Yukos Universal Limited (Isle of Man) v. Russian Federation (UNCITRAL (PCA Case No. 227)), Interim Award on Jurisdiction and Admissibility, 30 Nov. 2009, ¶¶ 538, 544–46; Veteran Petroleum Limited (Cyprus) v. Russian Federation (UNCITRAL (PCA Case No. 228)), Interim Award on Jurisdiction and Admissibility, 30 Nov. 2009, ¶¶ 549, 555–57 (together, the "*Yukos* ECT arbitrations").

[11] North American Free Trade Agreement, U.S.-Can.-Mex. (signed 17 Dec. 1992, entered into force 1 Jan. 1994), 35 I.L.M. 612 (1993). The full text of NAFTA's denial of benefits clause is set out in Annex A to the present article.

[12] At the time of writing, there are no publicly available records of notification or consultations concerning a NAFTA Party's denial of benefits.

Party.[13] While the denial of benefits clause in the 2012 U.S. Model BIT contains no requirement of prior consultation or notification, other IIAs signed by the U.S. contain such requirements. For instance, the Protocol to the 1986 U.S.-Egypt BIT includes a procedural requirement that the denying State Party must "promptly consult" with the other State Party once it decides to deny benefits to a company that falls within the scope of the denial of benefits clause.[14]

Likewise, the ASEAN Comprehensive Investment Agreement ("ASEAN Agreement") includes a detailed denial of benefits clause, which reflects certain elements of the denial of benefits clauses included in the U.S. Model BIT and in NAFTA.[15] Article 19(1) of ASEAN provides for the distinct situations which are generally found in this type of provision and in which a Member State "may deny the benefits" of the ASEAN Agreement to "an investor of another Member State that is a juridical person of such other Member State and to investments of such investor."[16]

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[13] On the timing and effect of denial of benefits clauses in this context, see *infra*, in particular the developments on *Ampal v. Egypt*.

[14] Treaty between the United States of America and the Arab Republic of Egypt Concerning the Reciprocal Encouragement and Protection of Investments (signed 11 Mar. 1986, entered into force 27 June 1992), Protocol, ¶ 1. The full text of this provision is set out in Annex A to the present article and is discussed further below.

[15] 2009 ASEAN Comprehensive Investment Agreement, available on ASEAN's website. The full text of this provision is set out in Annex A to the present article.

[16] Paragraph (a) of Article 19(1) provides that a Member State may deny benefits to an investor of another Member State owned or controlled by "an investor of a non-Member State" which has "no substantive business operations" in the territory of the other Member State. Pursuant to Article 19(1)(b), a Member State may deny benefits to an investor of another Member State owned or controlled by its own nationals and which has "no substantive business operations" in the territory of such other Member State. Article 19(1)(c) provides that benefits may be denied to an investor owned or controlled by

The denial of benefits clause in the ASEAN Agreement also includes a unique provision that concerns the investor's compliance with the law of the host State. Pursuant to Article 19(2), a Member State may deny benefits where it can establish "that such investor has made an investment" that violates the laws of the denying State "by misrepresenting its ownership in those areas of investment which are reserved for natural or juridical persons of the denying Member State." Similar restrictions exist in other IIAs, although an investor's obligation to comply with the laws of the host State may be found in provisions covering the definition of an investment,[17] the admission or establishment of investments,[18] or the general scope of the treaty.[19]

Article 10.12.2 of the Dominican Republic-Central America Free Trade Agreement ("CAFTA-DR")[20] somewhat departs from Article 17(2) of the U.S. Model BIT, although it replicates its wording. Under this provision, "a Party may deny the benefits of [Chapter 10 of CAFTA-DR on 'Investment'] to an investor of another Party that is an enterprise of such other Party and to investments of that investor" under two cumulative

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nationals of a non-Member State with whom the denying Member State has no diplomatic relations.

17 *See, e.g.,* 1994 Ukraine-Lithuania BIT, Art. 1(1), which defines investment as "every kind of asset invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter."

18 *See, e.g.,* 1995 Spain-El Salvador BIT, Art. 3, which provides that "[e]ach Contracting Party shall protect in its territory the investments made, in accordance with its legislation."

19 *See, e.g.,* 1986 Netherlands-Turkey BIT, Art. 2(2), which provides that it applies to investments made by nationals of one Contracting Party "which are established in accordance with the laws and regulations in the latter Contracting Party's territory at the time the investment was made."

20 Dominican Republic-Central America Free Trade Agreement (signed 28 May 2004, entered into force 1 Jan. 2009), 43 I.L.M. 514 (2004).

conditions. First, the investor must have "no substantial business activities in the territory of any Party, other than the denying Party." By excluding the host State from the restriction, this provision takes into account substantial business activity potentially occurring in the host State, and thus extends the protection to companies (for example subsidiaries of foreign companies) incorporated in the host State. Second, similar to the 2012 U.S. Model BIT, the enterprise must be owned or controlled by "persons of a non-Party, or of the denying Party."

However, a CAFTA-DR Party's right to deny benefits under Article 10.12.2 is expressly "subject to" the procedures in Article 18.3 (Notification and Provision of Information) and Article 20.4 (Consultations). Article 18.3 requires a CAFTA-DR Party, "[t]o the maximum extent possible," to notify one or more other CAFTA-DR Parties, but not an investor, "of any proposed or actual measure" that may affect the operation of the treaty and the other CAFTA-DR Party's interest thereunder, while Article 20.4 provides that "[a]ny Party may request in writing consultations with any other Party" concerning such measures."

Finally, the denial of benefits clause at Article 17 of the Energy Charter Treaty ("ECT")[21] is structured differently than denial of benefits clauses in treaties to which the U.S. is a party, although that provision was drafted with the U.S.'s active participation as a negotiating State.[22] Article 17 provides in its *chapeau* that each Contracting Party "reserves the right to deny the

[21] The text of the Energy Charter Treaty is available in European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects (signed 17 Dec. 1994, entered into force 19 Apr. 1998), 34 I.L.M. 367 (1995). *See also* ENERGY CHARTER SECRETARIAT, THE ENERGY CHARTER TREATY AND RELATED DOCUMENTS. A LEGAL FRAMEWORK FOR INTERNATIONAL ENERGY COOPERATION, available on the Energy Charter Treaty Secretariat's website.

[22] The U.S. subsequently did not sign the ECT.

advantages" of Part III of the ECT in the circumstances set forth in paragraphs 1 and 2. Article 17(2) of the ECT covers the classic situation of an investment made by an investor of a third State with which the denying State has no diplomatic relations, or against which it maintains economic sanctions. Under Article 17(1), a Contracting Party reserves the right to deny benefits to a "legal entity" if it is owned or controlled by "citizens or nationals of a third state" and it has "no substantial business activities in the Area of the Contracting Party in which it is organized."

The interaction between Article 17 and other provisions of the ECT differs from that of the denial of benefits clauses included in most other IIAs. Under Article 17, the Contracting Parties to the ECT reserve the right to deny the substantive investment protections contained in Part III of the ECT, but not the procedural mechanism of investor-State arbitration set forth at Article 26 of the ECT, which is contained in Part V of the ECT. As discussed below, a consistent series of arbitral awards has ascribed a scope and effect to Article 17 of the ECT that generally differs from the interpretation of denial of benefits clauses in treaties involving the U.S.

As a final point – and this is stating the obvious – a State cannot purport to deny the benefits of an IIA where that treaty contains no denial of benefits clause. In *Tokios Tokelės*,[23] Ukraine sought to deny the Claimant the benefits of the Ukraine-Lithuania BIT, which contains no denial of benefits clause, on the grounds that the Claimant lacked any "genuine link" with Lithuania, where it was incorporated, and that it was owned and controlled by Ukrainian nationals. The Tribunal rejected the notion that any general right to deny treaty benefits exists under international law

[23] Tokios Tokelės v. Ukraine (ICSID Case No. ARB/02/18), Decision on Jurisdiction (P. Weil, President, D. Price, P. Bernardini), 29 Apr. 2004, italaw website.

and regarded "the absence of [a denial of benefits] provision as a deliberate choice of the Contracting Parties."[24] The Tribunal concluded that it was not the role of arbitral tribunals "to impose limits on the scope of BITs not found in the text" or "limits nowhere evident from the negotiating history" of the BIT.[25]

II. CONDITIONS FOR THE APPLICATION OF DENIAL OF BENEFITS CLAUSES

As mentioned above, where an IIA includes a denial of benefits clause,[26] a State Party's right to deny treaty benefits is typically subject to two cumulative conditions. The first condition concerns the ownership or control of the company to whom benefits are being denied; the second condition concerns the question whether a company's business activities are substantial. As discussed below, tribunals have interpreted these conditions in a consistent manner, depending on the type of wording in IIAs.

Before addressing these cumulative conditions, however, it is important to emphasise two preliminary matters. First, unless a denial of benefits provision is contained in the definition of a protected "investor" under the relevant treaty, the operation of a denial of benefits clause is distinct from the characterisation of a company as an investor under the relevant treaty. In other terms, a defendant State may deny the benefits of a treaty regardless of the fact that a claimant has qualified as a protected investor pursuant to the definition of "investor" under the treaty; in other terms still, it is *because* a company qualifies as a protected investor that, under

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[24] *Id.* ¶ 36.

[25] *Id.*

[26] The situation covering diplomatic relations does not raise specific difficulties, and to the author's knowledge has never arisen. The remainder of this article will therefore focus on the second type of denial of benefits clause.

these types of provisions, it can be excluded from the treaty's protection by reason of the ownership or control exercised by nationals of a third State. As a matter of procedure, therefore, an arbitral tribunal must first determine whether a claimant qualifies as a protected investor before determining whether the defendant State has effectively exercised its right to deny the benefits of the relevant treaty to that investor. Conversely, where a tribunal has determined that a denial of benefits has not been validly exercised because the factual or legal conditions of ownership or control are not met, such a determination has no impact on the distinct – and logically prior – characterisation of the company under scrutiny as a qualified investor under the treaty.

Second, the State which seeks to deny benefits bears the burden of proving that the conditions enumerated in the denial of benefits clause are met.[27] This is consistent with the principle *actori incumbit probatio*, according to which the burden of proof of an allegation rests on the party advancing it.[28] Thus, while it is the claimant's burden to demonstrate that it meets the jurisdictional

[27] *See, e.g.,* Generation Ukraine, Inc. v. Ukraine (ICSID Case No. ARB/00/9), Award (J. Paulsson, President, E. Salpius, J. Voss), 16 Sept. 2003, ¶ 15.7, italaw website. *See also* the views expressed by the U.S. State Department in 1953, *in* VANDEVELDE, *supra* note 3, at 395–96: "During negotiations with the Netherlands, the question arose as to where the burden of proof lay. The State Department responded that the denying party is free to require the company to present reasonable proof that the company is entitled to treaty protection, in the event that such party wishes to invoke the reservation."

[28] *See, e.g.,* Azurix Corp. v. Argentine Republic, (ICSID Case No. ARB/01/12), Decision on the Application for Annulment (G. Griffith, President, B. Ajibola, M. Hwang), 1 Sept. 2009, ¶ 215, italaw website; Saipem SpA v. People's Republic of Bangladesh (ICSID Case No. ARB/05/07), Award (G. Kaufmann-Kohler, President, C. Schreuer, P. Otton), 30 June 2009, ¶ 113, italaw website; Avena and Other Mexican Nationals (Mexico v. United States of America), Judgment, 31 Mar. 2004, I.C.J. Reports 2004, at 12, ¶¶ 55–57 at 41; Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v. United States of America), Jurisdiction and Admissibility, Judgment, 26 Nov. 1984, I.C.J. Reports 1984, at 392, ¶ 101 at 437.

requirements under the treaty, a respondent State seeking to deny treaty benefits to an investor must prove that it has grounds for exercising its right to deny. This reasoning has been affirmed by tribunals interpreting both multilateral[29] and bilateral[30] treaties.

A. Meaning of Substantial Business Activities

Denial of benefits clauses in many IIAs contain a requirement that an investor not have "substantial business activities" in the territory where it is organized or, depending on the wording of the clause, in the territory of the denying State.

The Tribunal in the *AMTO* case provided some guidance on the interpretation of "substantial business activities" under Article 17(1) of the ECT. The Tribunal looked to Article 2 of the ECT, which sets out the purpose of the Treaty to establish a legal framework "in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits," and considered that "substantial" means "of substance" and not "of form," and that this should be determined by reference to the "materiality not the magnitude of the business activity."[31] The *AMTO* Tribunal was satisfied that the Claimant had met this

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[29] *See, e.g.*, Plama Consortium Limited v. Republic of Bulgaria (ICSID Case No. ARB/03/24), Decision on Jurisdiction (C.F. Salans, President, A.J. van den Berg, V.V. Veeder), 8 Feb. 2005, italaw website; Plama Consortium Limited v. Republic of Bulgaria (ICSID Case No. ARB/03/24), Award (C.F. Salans, President, A.J. van den Berg, V.V. Veeder), 27 Aug. 2008, italaw website; Limited Liability Company AMTO v. Ukraine (SCC Case No. 080/2005), Final Award (B.M. Cremades, President, P. Runeland, C. Soderlund), 26 Mar. 2008, italaw website; *Pac Rim*, *supra* note 6.

[30] *See, e.g.*, *Generation Ukraine*, *supra* note 27, and Empresa Eléctrica del Ecuador, Inc. v. Republic of Ecuador (ICSID Case No. ARB/05/9), Award (B. Sepúlveda, President, J. Rooney, W.M. Reisman), 2 June 2009, italaw website.

[31] *AMTO*, *supra* note 29, ¶ 69.

requirement, based on evidence that it conducted investment-related activities in Latvia, where it was organized, with a small but permanent staff.[32]

Adopting a similar approach, the Tribunal in *Pac Rim* analysed the meaning of "substantial business activities" under the denial of benefits clause in the CAFTA-DR. In that case, the Claimant was a U.S. holding company that had been previously held by a Cayman Islands holding company. The Respondent argued that the Claimant had no substantial business activities in the United States and that its alleged investments in El Salvador had in fact been made by its Canadian parent company or another affiliated company.[33] Applying the principles of treaty interpretation under the Vienna Convention, the *Pac Rim* Tribunal held that the "substantial business activities" requirement under Article 10.12.2 of the CAFTA-DR "relates not to the collective activities of a group of companies, but to activities attributable to the 'enterprise' itself, here the Claimant."[34] After analyzing the evidence, it concluded that the Claimant company was "akin to a shell company with no geographical location for its nominal, passive, limited and insubstantial activities,"[35] and placed particular emphasis on the fact that the Claimant's change of nationality from the Cayman Islands to the United States did not give rise to any material change in its business activities:

> In the Tribunal's view, the Claimant's case fails the simple factual test of distinguishing between its geographical activities before and after the change in nationality in December 2007. It is not possible from the evidence. . . for the Tribunal to identify any material difference between the

32 *Id.*

33 *Pac Rim*, *supra* note 6, ¶¶ 4.8–4.10.

34 *Id.* ¶ 4.66.

35 *Id.* ¶ 4.75.

> Claimant's activities as a company established in the Cayman Islands and its later activities as a company established in the USA: the location (or non-location) of the Claimant's activities remained essentially the same notwithstanding the change in nationality, and such activities were equally insubstantial.[36]

It is noteworthy that, because a denial of benefits is effective only if the treaty conditions are cumulatively met, it is generally not enough that a qualified investor has no substantial business activity in its country of incorporation:[37] the respondent State must show, in addition, that ownership and/or control belong to nationals of a third State (or nationals the host State, depending on a treaty's specific language). This is why the case law on denial of benefits has revolved more frequently around the second condition, that of ownership and control.

B. Meaning of Ownership and Control

While the concepts of "ownership" and "control" are often included as conditions for denial of benefits clauses, these terms are left undefined in most IIAs.[38]

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[36] *Id.* ¶ 4.73.

[37] *See*, *e.g.*, *Plama* Decision on Jurisdiction, *supra* note 29, ¶¶ 168–69; *Hulley*, *supra* note 10, ¶ 459; *Yukos Universal*, *supra* note 10, ¶ 460; *Veteran*, *supra* note 10, ¶ 516.

[38] One exception is the ASEAN Agreement, which includes a definition of "owned" and "controlled" in the third paragraph of the denial of benefits clause at Article 19. Article 19(3)(a) provides that the question of ownership is to be determined "in accordance with the laws, regulations and national policies of each Member States." Article 19(3)(b) states that "control" means "the power to name a majority of [an investor's] directors or otherwise to legally direct its actions." *See also* VANDEVELDE, *supra* note 3, at 395 (quoting the U.S. State Department in 1955): "The denial of benefits provision granted to the

The Decision on Jurisdiction in *Plama* was the first to consider the meaning of the words "own or control" under Article 17(1) of the ECT. In that case, Bulgaria argued that the Claimant was owned and controlled by a company incorporated in the British Virgin Islands, a territory not covered by the U.K's ratification instrument. The Tribunal considered that the word "or" in the first limb of Article 17(1) "signifies that ownership and control are alternatives" and that "only one need be met for the first limb to be satisfied." The Tribunal then interpreted both terms broadly, describing that:

> [O]wnership includes indirect and beneficial ownership; and control includes control in fact, including an ability to exercise substantial influence over the legal entity's management, operation and the selection of members of its board of directors or any other managing body.[39]

The *Plama* Tribunal ultimately concluded that a national of France, a Contracting Party to the ECT, owned and controlled the Claimant, such that Bulgaria could not rely on Article 17(1) to deny the Claimant the substantive protection to which it was entitled under Part III of the ECT.[40]

The Tribunal in the *Yukos* ECT arbitrations also elaborated on the meaning of "control" under Article 17(1) of the ECT.[41] The Russian Federation alleged to have denied benefits to the Claimant

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denying party 'broad latitude' to interpret the word 'controlling,' which could include any means of legal control." (citations omitted).

[39] *Plama* Decision on Jurisdiction, *supra* note 29, ¶ 170.

[40] *Plama* Award, *supra* note 29, ¶ 94–95.

[41] *Hulley*, *supra* note 10, ¶¶ 487–536; *Yukos Universal*, *supra* note 10, ¶¶ 460–537; *Veteran*, *supra* note 10, ¶¶ 518–48. For the purposes of this discussion, the Tribunals constituted in each of the three Yukos ECT arbitrations are considered to be a single Tribunal (L.Y. Fortier, President, C. Poncet, S.M. Schwebel).

companies, which it argued were owned and controlled by Russian nationals. While the Tribunal held that the Russian Federation's purported denial of benefits was defective,[42] it nevertheless proceeded to investigate, and found, that each of the Claimants was ultimately owned and controlled by UK trusts and thus could benefit from the Treaty's protection.[43]

Ownership and control have also been debated in cases interpreting denial of benefits clauses in U.S. BITs. For instance, in *Ulysseas v. Ecuador*, the Tribunal analysed Ecuador's objection that the Claimant company, while incorporated in Ecuador, was controlled by "nationals of a third country" within the meaning of the denial of benefits clause in the 1993 U.S.-Ecuador BIT.[44] As

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[42] The Russian Federation argued that it had denied benefits to the Claimants twice: first, when it concluded a Partnership and Cooperation Agreement with the European Union in 1994, according to which a company having only a registered office in a State Party is not considered a company of that State unless "its operations possess a real and continuous link" with the latter's economy, and second, when it declared in its First Memorial that it "denies any and all benefits of Part III of the Treaty to the Russian oligarchs themselves, and to each and every one of their offshore shell companies and structures." The Tribunal held that both purported denials were ineffective, as the Partnership and Cooperation Agreement makes no reference to the ECT and *vice versa*, and that even if the Russian Federation had exercised its right to deny benefits in its First Memorial, this "can only be prospective in effect from the date of that Memorial." *Hulley*, *supra* note 10, ¶¶ 445–46, 456–57; *Yukos Universal*, *supra* note 10, ¶¶ 446–47, 457–58; *Veteran*, *supra* note 10, ¶¶ 502–03, 513–14.

[43] *Hulley*, *supra* note 10, ¶¶ 535–36; *Yukos Universal*, *supra* note 10, ¶¶ 536–37; *Veteran*, *supra* note 10, ¶¶ 547–48.

[44] Ulysseas Inc. v. Ecuador (UNCITRAL), Final Award (P. Bernardini, President, M. Pryles, B. Stern), 12 June 2012, ¶¶ 164–65, italaw website. Article I(2) of the U.S.-Ecuador BIT provides that "[e]ach Party reserves the right to deny to any company the advantages of this Treaty if nationals of any third country control such company and, in the case of a company of the other Party, that company has no substantial business activities in the territory of the other Party or is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations."

in the *Plama* decision*,* the Tribunal considered that "control" over the Claimant could be exercised indirectly through several layers of companies in the corporate chain. In making this finding, the Tribunal referred to the general definition of a "national" of a Party at Article I(1)(c) of the BIT, which it noted was limited to natural persons, and considered that "in order to satisfy the control test under Article I(2) of the BIT the natural person who is the ultimate controller of [the Claimant] and its nationality must be identified."[45] The *Ulysseas* Tribunal ultimately accepted evidence that the Claimant was controlled by a U.S. national through a limited partnership, which owned 99% of the Claimant's direct parent company. In so finding, it rejected Ecuador's contention that the line of control by the U.S. national was broken by a joint venture agreement concluded by the limited partnership and a Bahamian entity, and that this contract gave control over the Claimant to the Bahamian entity and its ultimate shareholder. In the Tribunal's view, any control exercised by a national of a third State through this "contractual mechanism" could only affect "one line of [the Claimant's] business," and this did not amount to control over the company within the meaning of the denial of benefits clause.[46]

Finally, denial of benefits clauses typically refer to ownership and control of an investor by a "third State" or "non-Party." Most IIAs do not define these terms,[47] and their meaning would at first glance appear to be self-evident. The term "third State" did however give rise to debate in the *Yukos* ECT arbitrations. The Russian Federation argued that because it had

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[45] Ulysseas Inc. v. Ecuador (UNCITRAL), Interim Award (P. Bernardini, President, M. Pryles, B. Stern), 28 Sept. 2010, ¶ 170, italaw website.

[46] *Id.* ¶¶ 184–88.

[47] One exception is Article 10.28 of CAFTA, which defines "investor of a non-Party" as "an investor that attempts to make, is making, or has made an investment in the territory of that Party, that is not an investor of a Party."

signed, but not ratified, the ECT, it was not bound to provisionally apply the Treaty and could not qualify as a "Contracting Party," therefore being a "third State" within the meaning of the denial of benefits clause at Article 17(1).[48] After analyzing the language of the ECT and its *travaux préparatoires*, the Tribunal rejected this argument:

> The Treaty clearly distinguishes between a Contracting Party (and a signatory), on the one hand, and a third State, which is a non-Contracting Party, on the other. The Tribunal agrees with Claimant that, on their face, several provisions distinguish between a Contracting Party and a third State (for example, Articles (1)(7), 10(3) and 10(7), and 17) and that there is no equation in the ECT between a Contracting Party and a third State. This conclusion is further supported by the *travaux préparatoires*, which demonstrate that the term "third state" was substituted for the term "non-Contracting Party."[49]

The Tribunal's conclusion that a "third State" does not include a Contracting Party is consistent with Article 2(1)(h) of the Vienna Convention on the Law of Treaties ("Vienna Convention"), which defines a "third State" as "a State not a party to the treaty." It also reflects the fact that the drafters of the ECT, unlike those of other treaties, chose to not exclude from the Treaty's protection nationals of the host State.[50]

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[48] *Hulley*, *supra* note 10, ¶¶ 537–45; *Yukos Universal*, *supra* note 10, ¶¶ 538–46; *Veteran*, *supra* note 10, ¶¶ 549–57.

[49] *Hulley*, *supra* note 10, ¶ 543; *Yukos Universal*, *supra* note 10, ¶ 544; *Veteran*, *supra* note 10, ¶ 555.

[50] On different treaty languages, see *supra*, Section I.

III. OPERATION OF DENIAL OF BENEFITS CLAUSES

Once a State that seeks to deny benefits has established that the specific conditions enumerated in the clause of the relevant treaty are fulfilled, a number of further questions arise concerning the operation of denial of benefits clauses. A first question is whether the denial of benefits affects the jurisdiction of an arbitral tribunal over a particular claimant or the merits of the claims. A second and related issue concerns whether a State's right to deny benefits is subject to any time limit, and whether a denial of benefits only deprives an investor of protections from that date onwards, or whether it may also have "retrospective effect."

A. Does a Denial of Benefits Operate as an Exception to the Substantive Protections of the Treaty or to the Jurisdiction of a Tribunal?

Whether a respondent State's denial of benefits affects the tribunal's jurisdiction to hear the claims, or only the substantive protections under a treaty, turns on the wording and scope of the provision in question and its interaction with other provisions of the IIA.[51] In this connection, a clear distinction can be drawn between the case law concerning the ECT and that concerning other IIAs.

A consistent line of awards has held that the denial of benefits clause at Article 17(1) of the ECT operates as an exception to the substantive protections of the Treaty. In *Plama*, where this issue was first debated, Bulgaria sought to exercise its right under Article 17(1) to deny benefits at the preliminary stage

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[51] If denial of benefits is taken as affecting the tribunal's jurisdiction over a particular claimant, the tribunal's decision on this issue may be subsequently reviewed by a controlling authority, an *ad hoc* Committee under the ICSID Convention or the competent domestic courts under other arbitration rules.

of the proceedings. Bulgaria argued that if the Tribunal were to find that the requirements for its denial of benefits were present, this would "defeat Bulgaria's consent, which extends only to disputes involving a possible breach of Part III and would operate to defeat jurisdiction under Article 25 of the ICSID Convention."[52]

In its 2005 Decision on Jurisdiction, the *Plama* Tribunal rejected Bulgaria's argument and concluded that Article 17(1) had no relevance to its jurisdiction.[53] Interpreting Article 17(1) in light of Article 31(1) of the Vienna Convention, the Tribunal stated that the "express terms" of Article 17(1) "refer to a denial of the advantages 'of this Part', thereby referring to the substantive advantages conferred upon an investor by Part III of the ECT."[54] The Tribunal emphasized that, unlike most modern IIAs, Article 17(1) of the ECT does not operate to deny all benefits of the ECT and does not interact with the procedural mechanism of investor-State arbitration at Article 26 of the ECT, which is contained in Part V. The Tribunal further considered that Bulgaria's interpretation of Article 17(1) would be contrary to the object and purpose of the ECT:

> Article 26 provides a procedural remedy for a covered investor's claims; and it is not physically or juridically part of the ECT's substantive advantages enjoyed by that investor under Part III. As a matter of language, it would have been simple to exclude a class of investors completely from the scope of the ECT as a whole, as do certain other bilateral investment treaties; but that is self-evidently not the approach taken in the ECT. This limited exclusion from Part III for a covered investor, dependent on certain specific criteria, requires a procedure to resolve a dispute as to whether that exclusion applies in any particular case; and

52 *Plama*, Decision on Jurisdiction, *supra* note 29, ¶ 85.

53 *Id.* ¶ 240(A)(2).

54 *Id.* ¶ 147.

> the object and purpose of the ECT, in the Tribunal's view, clearly requires Article 26 to be unaffected by the operation of Article 17(1).[55]

The Tribunal in the *Yukos* ECT arbitrations followed the reasoning in *Plama*, and confirmed that Article 17(1) operates to deny an investor the substantive protections under Part III of the ECT, but does not deprive the Tribunal of jurisdiction over the dispute:

> Article 17 specifies—as does the title of that Article—that it concerns denial of the advantages of 'this Part,' *i.e.*, Part III of the ECT. Provision for dispute settlement under the ECT is not found in 'this Part' but in Part V of the Treaty. Whether or not Claimant is entitled to the advantages of Part III is a question not of jurisdiction but of the merits. Since Article 17 relates not to the ECT as a whole, or to Part V, but exclusively to Part III, its interpretation for that reason cannot determine whether the Tribunal has jurisdiction to entertain the claims of Claimant.[56]

Referring to the *Plama* case, the Tribunal in the *Stati* case equally held that the denial of benefits at Article 17(1) applies only to the substantive protections under the ECT and does not raise a jurisdictional issue.[57]

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55 *Id.* ¶ 148. During the subsequent merits phase of the *Plama* arbitration, Bulgaria contended that the operation of the denial of benefits provision at Article 17(1) rendered the claims inadmissible (*Plama* Award, *supra* note 29, ¶ 87). Having found that the conditions for a denial of benefits were not present, the *Plama* Tribunal did not reach a finding on whether Article 17(1) would affect the admissibility of the claims.

56 *Hulley*, *supra* note 10, ¶ 440; *Yukos Universal*, *supra* note 10, ¶ 441; *Veteran*, *supra* note 10, ¶ 497.

57 Anatolie Stati, Gabriel Stati, Ascom Group S.A. and Terra Raf Trans Traiding Ltd. v. Republic of Kazakhstan (SCC Case No. V (116/2010)), Award

Tribunals interpreting denial of benefits clauses in multilateral treaties other than the ECT have reached a different conclusion on this issue, given the different wordings at play. In *Pac Rim*, the Tribunal took the position that Article 10.2.2 of the CAFTA-DR applies to "all the benefits conferred upon the investor" under the investment chapter of the treaty, and concluded that the "jurisdictional issue. . . does not therefore resemble the more limited issue under Article 17(1) of the Energy Charter Treaty."[58]

While there is currently no available case law on the denial of benefits clause in the ASEAN Agreement or NAFTA, the language and structure of those treaties entail that a State's denial of benefits would affect a tribunal's jurisdiction. Articles 19(1) and 19(2) of the ASEAN Agreement both provide that "[a] Member State may deny the benefits of this Agreement." Because the ASEAN Agreement is a single-chapter investment agreement, the denial of benefits clause would deprive a claimant of the benefits of the entire Treaty, including its right to investor-State dispute resolution under Article 32. Similarly, Article 1113 of NAFTA provides that "[a] Party may deny the benefits of this Chapter," which refers to Chapter 11 of NAFTA ("Investment") and would deprive a claimant of the right to invoke the investor-State dispute resolution provisions at Article 1120 of NAFTA, which is contained in Chapter 11.

Denial of benefits clauses included in BITs may also function to deny benefits of the entire BIT, including the investor-State dispute resolution provision, when the language of the denial of benefits clause specifically refers to "this treaty" or "this

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(K.H. Böckstiegel, President, D. Haigh, S.N. Lebedev), 19 Dec. 2013, ¶ 745, italaw website.

58 *Pac Rim*, *supra* note 6, ¶ 4.4.

agreement".[59] For example, in *Ulysseas*,[60] Ecuador invoked the denial of benefits contained in Article I(2) of the Ecuador-U.S. BIT, which provides that "[e]ach Party reserves the right to deny any company the benefits of this Treaty." At the outset of its discussion of the issue, the *Ulysseas* Tribunal noted that "a valid exercise of the right [to deny benefits] would have the effect of depriving the Tribunal of jurisdiction under the BIT."[61] Likewise, in *Empresa Eléctrica*, a case where Ecuador invoked the same provision of the U.S.-Ecuador BIT, the Tribunal considered that denial of benefits affects its jurisdiction.[62]

B. Timing and Effect of Denial of Benefits

In early investment treaty cases, States sought to argue that a denial of benefits clause operates automatically where the conditions set forth in the clause are present. This position has been rejected in the case law, and it is now uncontroversial that a State must actively exercise its right under a provision to effectively deny the benefits of a treaty to an investor. In *Plama*, for example, Bulgaria argued that Article 17(1) of the ECT "requires no action" by the denying State and that its right to deny benefits should instead operate automatically where the

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[59] Generally speaking, tribunals have decided the issue in terms of jurisdiction. Not all tribunals interpreting denial of benefits clauses in BITs have followed this logic, however. In a relatively early decision, the Tribunal in *Generation Ukraine* interpreted the denial of benefits clause at Article I(2) of the U.S.-Ukraine BIT, which provides for the right to deny the advantages of the entire Treaty, as a "potential filter on the admissibility of claims which can be invoked by the respondent State." The Tribunal ultimately found the denial of benefits clause to be inapplicable as the Claimant was controlled by a U.S. national, and not a third party to the BIT (*Generation Ukraine*, *supra* note 27, ¶ 15.7).

[60] *Ulysseas*, Interim Award*, supra* note 45, ¶ 164.

[61] *Id.* ¶ 172.

[62] *Empresa Eléctrica, supra* note 30, ¶ 71.

circumstances set forth in paragraphs 1 and 2 are present. Rejecting this argument, the Tribunal held that "the existence of a 'right' is distinct from the exercise of that right" and that it remains within a State's discretion whether to deny benefits to an investor where the conditions set forth in Article 17 are present. In the Tribunal's view, should an ECT Contracting Party seek to exercise its right to deny benefits, "[t]he exercise would necessarily be associated with publicity or other notice so as to become reasonably available to investors and their advisers."[63] In the *Yukos* ECT arbitrations, the Tribunal followed the finding in *Plama*, and concluded that until an ECT Contracting Party actively exercises its right to deny benefits, an investor will benefit from the protections of Part III of the Treaty.[64]

By contrast, an enduring issue concerns whether a State may deny treaty benefits after an investor has submitted a claim to arbitration, and whether a denial of benefits will deprive an investor of protections under a treaty with "retrospective effect." Here, again, the outcome is determined by the treaty's language, namely whether the provision denies the benefits of the entirety of the treaty or the entirety of the investment chapter, or only part thereof.

The timing and effect of a denial of benefits was first raised in case law in relation to Article 17(1) of the ECT. In *Plama*, the Tribunal concluded that the object and purpose of the ECT "to promote long-term cooperation in the energy sector" entailed that Bulgaria's purported exercise of its right under Article 17(1) to deny the Claimant the substantive protections of Part III of the ECT could only have prospective effect, and could not serve to deny benefits "retrospectively" to the time it had made its

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63 *Plama*, Decision on Jurisdiction, *supra* note 29, ¶¶ 155–57.

64 *Hulley*, *supra* note 10, ¶¶ 455–58; *Yukos Universal*, *supra* note 10, ¶¶ 456–59; *Veteran*, *supra* note 10, ¶¶ 512–15.

investment over four years earlier.[65] In the Tribunal's view, if "the right's exercise had retrospective effect. . . [t]he investor could not plan in the 'long term' for such an effect (if at all)."[66] It reasoned that an investor should be entitled to "reasonable notice" and that Article 17(1) could only be invoked before the time of the investment:

> At that stage, the putative investor can so plan its business affairs to come within or without the criteria there specified, as it chooses. It can also plan not to make any investment at all or to make it elsewhere. After an investment is made in the host state, the 'hostage factor' is introduced; the covered investor's choices are accordingly more limited; and the investor is correspondingly more vulnerable to the host state's exercise of its right under Article 17(1) ECT.[67]

In the *Yukos* ECT arbitrations, the Tribunal likewise considered that even if the Russian Federation had validly exercised its right under Article 17(1) of the ECT (which it had not), the denial of benefits "can only be prospective in effect" from the date of denial.[68] The *Yukos* Tribunal took no view on the conclusion reached in *Plama* that a State is required to invoke Article 17(1) before an investor makes its investment.

Tribunals in more recent ECT cases have also concluded that Article 17(1) cannot be invoked after a claim is submitted to arbitration and cannot be given "retrospective effect." In *Liman*, for example, the Tribunal held that the requirement under Article 17(1) that a Contracting Party exercise its right to deny benefits "can only lead to the conclusion that this notification has

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65 *Plama*, Decision on Jurisdiction, *supra* note 29, ¶ 165.

66 *Id.* ¶ 162.

67 *Id.* ¶ 161.

68 *Hulley*, *supra* note 10, ¶ 457; *Yukos Universal*, *supra* note 10, ¶ 458; *Veteran*, *supra* note 10, ¶ 514.

prospective but no retrospective effect." It concluded that Kazakhstan had invoked Article 17(1) "belatedly since it was more than a year after Claimants had filed their Request for Arbitration."[69] The Tribunal considered it unnecessary to decide whether a Contracting Party would be required to notify an investor of its intent to rely on Article 17(1) prior to making the investment.

More recently, in *Khan Resources v. Mongolia*, the Tribunal drew heavily on the reasoning in *Plama* and considered that a State would be required to notify its intent to deny benefits to an investor before it has made its investment. Mongolia had invoked Article 17(1) for the first time as part of its objections to the Tribunal's jurisdiction. The Tribunal began its analysis by noting that this was a question "for the merits, not jurisdiction." It went on to consider the appropriate timing of a denial of benefits under Article 17(1) and considered that, in light of the object and purpose of the ECT, a denial of benefits must be made at a time that gives adequate notice to an investor:

> The Treaty seeks to create a predictable legal framework for investments in the energy field. This predictability materializes only if investors can know in advance whether they are entitled to the protections of the Treaty. If an investor such as Khan Netherlands, who falls within the definition of 'Investor' at Article 1(7) of the Treaty and is therefore entitled to the Treaty's protections in principle, could be denied the benefit of the Treaty at any moment after it has invested in the host country, it would find itself in a highly unpredictable situation. This lack of certainty would impede the investor's ability to evaluate whether or

[69] Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan (ICSID Case No. ARB/07/14), Award (K.H. Böckstiegel, President, K. Hobér, J. Crawford), 22 June 2010, ¶¶ 225–26, italaw website.

> not to make an investment in any particular state. This would be contrary to the Treaty's object and purpose.[70]

In contrast to decisions concerning Article 17(1) of the ECT, tribunals interpreting denial of benefits clauses in the CAFTA-DR and in U.S. BITs, which apply to the relevant treaty or the investment chapter in their *entirety*, have generally held that a State may deny benefits either before or after an investor submits a dispute to arbitration, provided that it does so within the applicable procedural time limits for raising objections to jurisdiction.[71]

In *Pac Rim*, for example, El Salvador raised the denial of benefits issue as an objection to jurisdiction, over two years after the Claimant had submitted its claim to arbitration.[72] In that case, the United States and Costa Rica filed submissions as Non-Disputing Parties on the interpretation of the denial of benefits clause. Notably, the United States described the "long-standing U.S. policy to include a denial of benefits provision in investment agreements to safeguard against the potential problem of 'free

[70] Khan Resources Inc., Khan Resources B.V., CAUC Holding Company, Inc. v. Government of Mongolia (UNCITRAL (PCA Case No. 2011-09)), Decision on Jurisdiction (D.A.R. Williams, President, L.Y. Fortier, B. Hanotiau), 25 July 2012, ¶ 426, italaw website. In the *Stati* case, the Tribunal reached a slightly different conclusion than in *Plama,* and considered that Article 17(1) "would only apply if a state invoked that provision to deny benefits to an investor before a dispute arose," rather than before the investment is made. Having already found that the substantive conditions under Article 17(1) were not met in that case, the Tribunal did not elaborate on the reasons for this statement (*Stati*, *supra* note 57, ¶ 745).

[71] Compare, *e.g.*, with the position taken by the U.S. State Department in 1953 in relation to the first U.S. BITs, *in* VANDEVELDE, *supra* note 3, at 394: "Thus, the denial of benefits clause preserved the states and the federal government 'the same freedom of action as they have in the absence of the treaty, to deal as they see fit with such corporations. That is, the clause makes it clear that such corporations cannot claim treaty rights as against domestic legislation now or hereafter enacted.'" (citations omitted).

[72] *Pac Rim*, *supra* note 6, ¶ 4.84.

rider' investors" and that any requirement that a CAFTA-DR Party invoke the denial of benefits clause before a claim is submitted to arbitration "would place an untenable burden on that Party . . . to monitor the ever-changing business activities of all enterprises in the territories of each of the other six CAFTA-DR Parties that attempt to make, are making or have made investments in the territory of the respondent."[73]

In its Decision on Jurisdiction, the *Pac Rim* Tribunal noted at the outset that it would not follow the decisions in the *Plama* or the *Yukos* ECT arbitrations given the "different wording, context and effect" of the denial of benefits clause in the ECT. Applying Article 31(1) of the Vienna Convention to the denial of benefits clause, it concluded that "[t]here is no express time-limit in CAFTA for the election by a CAFTA Party to deny benefits" and that "the Respondent's consent to ICSID Arbitration in CAFTA is necessarily qualified from the outset by [the denial of benefits clause at] Article 10.12.2."[74] To determine the applicable time limit for a denial of benefits, it applied ICSID Arbitration Rule 41, pursuant to which a claimant must submit its jurisdictional objections no later than the date fixed for the filing of the counter-memorial.[75] Having found that both the substantive and procedural requirements for the denial of benefits were met, the Tribunal held that it lacked jurisdiction over the claims.

The Tribunal in *Ulysseas* reached a similar conclusion concerning the denial of benefits provision in the U.S.-Ecuador BIT, which Ecuador had invoked six months after the Claimant had filed its notice of arbitration under the UNCITRAL Rules. In the Tribunal's view, "[n]othing in the [denial of benefits clause] at

[73] *Pac Rim*, Submission of the United States of America, 20 May 2011, ¶¶ 3, 6, italaw website.

[74] *Pac Rim*, *supra* note 6, ¶¶ 4.83, 4.90.

[75] *Id.* ¶ 4.85.

Article I(2) of the BIT excludes that the right to deny the BIT's advantages be exercised by the State at the time when such advantages are sought by the investor through a request for arbitration" and "the protection afforded by the BIT is subject during the life of the investment to the possibility of a denial of the BIT's advantages by the host State."[76] The Tribunal held that Ecuador could validly exercise its right to deny benefits within the time limit imposed by the UNCITRAL Arbitration Rules, which provide that the respondent may raise a jurisdictional objection no later than the statement of defence, with the effect that its jurisdiction over the claims would be terminated from that date.[77]

In the *Rurelec* case,[78] the Tribunal also rejected the Claimant's contention that the denial of benefits clause in the U.S.-Bolivia BIT could only have effect if invoked before the notice of arbitration was submitted, holding that such a requirement would run counter to "[t]he very purpose of the denial of benefits. . . to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits."[79] The Tribunal considered that as a practical matter, it would be "odd" for a State to examine whether it should deny treaty benefits before a dispute with an investor had arisen:

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[76] *Ulysseas*, Interim Award, *supra* note 45, ¶¶ 172–73.

[77] In *Empresa Eléctrica*, which was decided under the same BIT, the Tribunal similarly considered that Ecuador "has announced the denial of benefits [to the Claimant] at the proper stage of the proceedings, i.e. upon raising its objections to jurisdiction." The Tribunal ultimately denied jurisdiction on other grounds and did not decide on the denial of benefits issue (*Empresa Eléctrica*, *supra* note 30, ¶ 71).

[78] Guaracachi America, Inc. and Rurelec PLC v. Plurinational State of Bolivia (UNCITRAL (PCA Case No. 2011-17)), Award (J.M. Júdice, President, M. Conthe, R.E. Vinuesa), 31 Jan 2014, ¶¶ 378–84, italaw website.

[79] *Id.* ¶ 376.

> the fulfilment of the [requirements of a denial of benefits clause] is not static and can change from one day to the next, which means that it is only when a dispute arises that the respondent State will be able to assess whether such requirements are met and decide whether it will deny the benefits of the treaty in respect of that particular dispute.[80]

The *Rurelec* Tribunal concluded that Bolivia's denial of benefits to one of the two Claimants, Guaracachi America Incorporated (GAI), almost two years after it filed its notice of arbitration "was made in good time"[81] because it complied with the time limit under the UNCITRAL Rules. Noting that it was "perhaps unusual for both the fact that leads to a lack of jurisdiction and the submission of the related jurisdictional objection to arise at the same time," the Tribunal concluded that the effect of Bolivia's denial of benefits was to exclude its jurisdiction over GAI's claims.[82]

As the foregoing analysis shows, a divide has emerged in the case law interpreting the denial of benefits clause at Article 17(1) of the ECT on the one hand, and denial of benefits clauses in other multilateral treaties and U.S. BITs, on the other. Beginning with *Plama*, tribunals interpreting Article 17(1) of the ECT have held that a host State cannot deny treaty benefits after a claim has been submitted to arbitration, as this would give the denial of benefits clause "retrospective effect." Tribunals interpreting denial of benefits in the CAFTA-DR and in U.S. BITs have held that a host State may validly invoke the denial of benefits clause after a claim is submitted to arbitration, if this complies with the time limit set forth in the applicable procedural rules.

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80 *Id.* ¶ 376.

81 *Id.* ¶ 382.

82 *Id.* ¶ 381.

The difference in language and structure between the ECT and other treaties explains these divergent outcomes. As discussed above, Article 17(1) of the ECT functions to deny an investor the benefits of the substantive protections contained in Part III of that Treaty. It does not, however, affect the investor's right to submit disputes to investor-State arbitration pursuant to Article 26. Where a company has submitted to arbitration a dispute over alleged violations of its substantive rights under the ECT, it would frustrate that company's legitimate expectations that its claim be heard in arbitration if the respondent State were to then exercise its right under Article 17(1) with retrospective effect. On the other hand, denial of benefits clauses in other treaties raise a jurisdictional issue, as they function to deny benefits of the entire treaty or investment chapter, *including* the investor-State dispute resolution clause. The consent given by the State parties to arbitrate investment disputes is therefore subject to their right to deny the benefits of the entire treaty or investment chapter, provided that the substantive conditions in the denial of benefits clause are met. In that context, tribunals interpreting these provisions have generally not held that allowing a host State to deny benefits after a claim is submitted to arbitration gives the clause "retrospective effect;"[83] rather, they have simply held that a denial of benefits causes the arbitral tribunal to lack jurisdiction to hear the claims on the merits.

This clear trend in the case law concerning U.S. treaties, however, was broken by the decision on jurisdiction rendered in

[83] One exception is the *Ulysseas* case, where the Tribunal noted that it had found "no valid reasons to exclude retrospective effects." (*Ulysseas*, Interim Award, *supra* note 45, ¶ 173. However, the effect of the Tribunal's holding was prospective only: in finding that Ecuador had validly denied benefits to the Claimant, the Tribunal held that its jurisdiction would be terminated from the date of denial. The Tribunal ultimately considered the merits of the case, and held that Ecuador had not breached any of its obligations under the treaty.

Ampal v. Egypt.[84] Under the denial of benefits provision in the Protocol to the applicable U.S.-Egypt BIT, the State Parties have reserved their right to deny the treaty's benefits to investors owned and controlled by third State nationals. The Protocol includes a further requirement that the denying State "promptly consult" with the other Party concerning any decision to deny benefits in order "to seek a mutually satisfactory resolution of this matter."[85] In this context, the Claimants submitted their request for arbitration under the U.S.-Egypt BIT in May 2012. In January 2013, Egypt exercised its right to deny the treaty's benefits to one of the Claimants, Ampal-American Israel Corporation, a U.S.-incorporated company owned and controlled by an Israeli national; one day later, Egypt initiated consultations with the United States. There was no dispute that the company was controlled by a third State national and fell within the scope of the denial of benefits clause. However, the Claimants argued that Egypt was required under the Protocol to initiate consultations with the United States before denying benefits, and could not do so after their claims had been submitted to arbitration.

At the outset of its analysis, the *Ampal* Tribunal noted that the case law could be broadly separated between cases interpreting Article 17(1) of the ECT and the denial of benefits clauses in U.S. BITs and the CAFTA, and that the Protocol to the U.S.-Egypt BIT had more in common with the clauses interpreted in the latter category of cases.[86] Interpreting the Protocol, however, the Tribunal considered that the State Parties' agreement to "promptly consult" concerning a denial of benefits would have required

84 Ampal-American Israel Corporation v. Arab Republic of Egypt (ICSID Case No. ARB/12/11), Decision on Jurisdiction (L.Y. Fortier, President, F. Orrego Vicuña, C. McLachlan), 1 Feb. 2016, italaw website.

85 The full text of the denial of benefits clause at Paragraph 1 of the Protocol to the U.S.-Egypt BIT is set out in Annex A to the present article.

86 *Ampal*, *supra* note 84, ¶ 129.

Egypt to initiate consultations with the United States *before* denying benefits to an investor, and even before the arbitration was brought. In so finding, it declined to follow the record of diplomatic correspondence submitted in the arbitration, in which Egypt and the United States had confirmed that they had engaged in two rounds of consultations on the denial of benefits issue and had reached a mutually satisfactory resolution of the matter through the consultations.[87] In the Tribunal's view, "valid and effective consultations" should have been held during the six-month period after the Claimants had submitted their notification of a legal investment dispute under the BIT, *i.e.*, during the same six-month window during which Egypt was separately required to engage in consultations with the Claimants under the investor-State dispute resolution provision. Having held that the prompt consultations did not take place, the Tribunal concluded that Egypt's denial of benefits was "defective and invalid."[88]

The *Ampal* Tribunal further considered the disputing parties' "detailed and extensive arguments" concerning the effect of Article 25(1) of the ICSID Convention on the denial of benefits. Referring to the wording of Article 25(1), which provides that "when the parties have given their consent, no party may withdraw its consent unilaterally," the Tribunal considered that the jurisdiction of ICSID should be determined at the time the Request

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[87] More specifically, the Contracting Parties engaged in a series of correspondence concerning "whether the company is, in fact, controlled within the meaning of the Protocol." Following such consultations, on 8 March 2014, the United States wrote, "The Department of State further acknowledges that the good faith consultations, and the absence of any expressed disagreement, between the United States of America and the Arab Republic of Egypt constitute a mutually satisfactory resolution of this matter, in accordance with Paragraph 1 of the Supplementary Protocol to the Treaty." The Government of the Arab Republic of Egypt confirmed this understanding on 17 April 2014. *Ampal*, *supra* note 84, ¶¶ 138–42, 147–51.

[88] *Id.* ¶ 162.

for Arbitration is registered, and "there cannot be an embedded conditionality in the Treaty which could be triggered after the submission of the dispute to arbitration."[89] The Tribunal's comments reinforced its interpretation that consultations under the U.S.-Egypt BIT concerning a denial of benefits should take place before an investor submits its claim to arbitration. In so finding, the *Ampal* Tribunal broke with other tribunals deciding objections based on denial of benefits provisions in U.S. BITs: each of the Tribunals in *Pac Rim*, *Rurelec* and *Empresa Eléctrica* cases had held that the time limit for a denial of benefits should be determined by reference to the procedural rules applicable to the arbitration. In addition, in seeking to preserve the investor's consent to arbitration under Article 25 of the ICSID Convention, the *Ampal* Tribunal overlooked the determination by the two Contracting States – the U.S. and Egypt – that the consultations had validly taken place under the Protocol and had resulted in a "mutually satisfactory resolution" of the matter. Although it was faced with evidence showing the Contracting States' common understanding of how the Protocol is to operate – namely, prompt consultations *after* a denial of benefits, not before – as well as the effect of a denial of benefits – namely, exclusion of a tribunal's jurisdiction, regardless of whether or not consent to arbitration has been given by the investor – the *Ampal* Tribunal chose to hold Egypt's denial of benefits as having been invalidly exercised. Under this reasoning, however, the host State could never deny the benefits of the U.S.-Egypt BIT (including the arbitration agreement) after an investor has initiated an arbitration, which is clearly not consistent with the language of the Supplementary Protocol to the Treaty or, more generally, denial of benefits clauses in U.S. BITs.

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[89] *Id.* ¶¶ 164, 169.

CONCLUSION

Denial of benefits clauses are an important mechanism by which State parties can, in specific circumstances and subject to specific conditions, achieve a policy of excluding certain categories of investors from the benefits of IIAs. However, careful attention should be paid to treaty drafting in order to ensure that the investors falling within the scope of a denial of benefits clause, as well as the procedural requirements for invoking the clause, are clearly defined in order for this policy to be achieved. Consistent case law on denial of benefits under the ECT has confirmed that a respondent State will not be permitted to frustrate an investor's legitimate expectations by denying it treaty benefits after that investor has submitted to arbitration a dispute over alleged violations of its substantive rights under the ECT. While most arbitral tribunals interpreting denial of benefits clauses in U.S. treaties have adopted a different approach by allowing a respondent State to deny benefits before or after a company submits a dispute to arbitration, the *Ampal* decision has called this policy into question and, while it remains an anomalous case, provides an important warning to State parties when negotiating IIAs and when subsequently invoking their right to deny treaty benefits.

ANNEX A

DENIAL OF BENEFITS CLAUSES IN INTERNATIONAL INVESTMENT AGREEMENTS

Treaty of Friendship, Commerce and Navigation between the United States of America and China dated 4 November 1946

Article XXVI(5)

> The provisions of this Treaty shall not be construed to accord any rights or privileges to corporations and associations engaged in political activities or with respect to the organization of or participation in such corporations and associations. Moreover, each High Contracting Party reserves the right to deny any of the rights and privileges accorded by this Treaty to any corporation or association created or organized under the laws and regulations of the other High Contracting Party which is directly or indirectly owned or controlled, through majority stock ownership or otherwise, by nationals, corporations or associations of any third country or countries.

Treaty of Amity and Economic Relations between the United States of America and Ethiopia dated 7 September 1951

Article VII(3)

> Neither High Contracting Party shall be obligated (a) to accord the advantages of the succeeding Articles of the present Treaty to any to any company the ownership or direction of which nationals of third countries have directly or indirectly a controlling interested, or (b) to permit religious philanthropic and cultural organizations to engage in commercial or other activities for pecuniary profit.

2012 United States Model Bilateral Investment Treaty

Article 17: Denial of Benefits

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

North American Free Trade Agreement ("NAFTA") dated 1 January 1994

Chapter 11, Investment; Article 1113: 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 Party and to investments of such investor if investors of a non-Party own or control the enterprise and the denying Party:

(a) does not maintain diplomatic relations with the non-Party; or

(b) adopts or maintains measures with respect to the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.

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

ASEAN Comprehensive Investment Agreement dated 26 February 2009

Article 19 – Denial of Benefits

1. A Member State may deny the benefits of this Agreement to:

(a) an investor of another Member State that is a juridical person of such other Member State and to investments of such investor if an investor of a non-Member State owns or controls the juridical person and the juridical person has no substantive business operations in the territory of such other Member State;

(b) an investor of another Member State that is a juridical person of such other Member State and to investments of such investor if an investor of the denying Member State owns or controls the juridical person and the juridical person has no substantive business operations in the territory of such other Member State; and

(c) an investor of another Member State that is a juridical person of such other Member State and to an investment of such investor if investors of a non-Member State own or control the juridical person, and the denying Member State does not maintain diplomatic relations with the non-Member State.

2. Following notification to the Member State of the investor, and without prejudice to paragraph 1, a Member State may deny the benefits of this Agreement to investors of another Member State and to investments of that investor, where it establishes that such investor has made an investment in breach of the domestic laws of the denying Member State by misrepresenting its ownership in those areas of investment which are reserved for natural or juridical persons of the denying Member State.

3. A juridical person is:

(a) "owned" by an investor in accordance with the laws, regulations and national policies of each Member States;

(b) "controlled" by an investor if the investor has the power to name a majority of its directors or otherwise to legally direct its actions.

Thailand-Australia Free Trade Agreement dated 1 January 2005

Part IV, Promotion and Protection of Investments; Article 911 – Denial of Benefits

> Subject to prior notification and consultation, a Party may deny the benefits of this Part to an investor of the other Party that is a juridical person of such Party and to investments of such an investor where the Party establishes that the juridical person is owned or controlled by persons of a non-Party and has no substantive business operations in the territory of the other Party.

Dominican Republic-Central America Free Trade Agreement ("CAFTA-DR") dated 5 August 2004

Chapter 10, Investment; 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.

Energy Charter Treaty ("ECT") dated 17 December 1994

Part III, Investment Promotion and Protection; Article 17 – Non-application of Part III in certain circumstances

> Each Contracting Party reserves the right to deny the advantages of this Part to:
>
> (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized; or
>
> (2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third state with or as to which the denying Contracting Party:
>
> > (a) does not maintain a diplomatic relationship; or
> >
> > (b) adopts or maintains measures that:
> >
> > > (i) prohibit transactions with Investors of that state; or
> > >
> > > (ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that state or to their Investments.

Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment dated 27 August 1993

Article I(2)

> Each Party reserves the right to deny to any company the advantages of this Treaty if nationals of any third country control such company and, in the case of a company of the other Party, that company has no substantial business activities in the territory of the other Party or is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations.

Treaty between the United States of America and Ukraine concerning the Encouragement and Reciprocal Protection of Investment dated 4 March 1994

Article I(2)

> Each Party reserves the right to deny to any company the advantages of this Treaty if nationals of any third country control such company and, in the case of a company of the other Party, that company has no substantial business activities in the territory of the other Party or is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations.

Treaty between the Government of the United States of America and the Government of the Republic of Bolivia concerning the Encouragement and Reciprocal Protection of Investment dated 17 April 1998

Article XII

> Each Party reserves the right to deny to a company of the other Party the benefits of this Treaty if nationals of a third country own or control the company and:
>
> > (a) the denying Party does not maintain normal economic relations with the third country; or
> >
> > (b) the company has no substantial business activities in the territory of the Party under whose laws it is constituted or organized.

Treaty between the United States of America and the Arab Republic of Egypt Concerning the Reciprocal Encouragement and Protection of Investments dated 11 March 1986

Protocol

> On signing the Treaty concerning the Reciprocal Encouragement and Protection of Investments, the Arab Republic of Egypt and the United States of America have, in addition, agreed on the following provisions which should be regarded as an integral part of the Treaty:
>
> > 1. Each Party reserves the right to deny the benefits of this Treaty to any company of either Party, or its affiliates or subsidiaries, if nationals of any third country control such company, affiliate or subsidiary; provided that, whenever one Party concludes that the benefits of this Treaty should not be extended for this reason, it shall promptly consult

with the other Party to seek a mutually satisfactory resolution of this matter.

2. "Control" means to have a substantial share of ownership rights and the ability to exercise decisive influence. Differences as to the existence of control shall be resolved according to the provisions of Article VIII.