**COLLEGE OF LAW AND GOVERNANCE**

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# Analyzing the Bilateral Investment Treaties of Ethiopia in light of *Treaty-Shopping*

**A Thesis Submitted in Partial Fulfillment of the Requirements of LL.M Degree in Commercial and Investment Law**

**By:**

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**16 June 2017**

***Jimma***

**Ethiopia**

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**16 June 2017**

## Declaration

**Analyzing the Bilateral Investment Treaties of Ethiopia in light of *Treaty-Shopping***

*I, Hailu Nega, hereby declare that "Analyzing the Bilateral Investment Treaties of Ethiopia in light of Treaty-Shopping" is my own original work. To this end, no work identical to this has been submitted for any degree or examination in any other university. Whenever the works others are quoted, it's with due acknowledgement.*

Student*: Hailu Nega* ________________________

Student ID No. RM 9711/08

**Analyzing the Bilateral Investment Treaties of Ethiopia in light of *Treaty-Shopping***

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Table of Contents

Acronyms and Abbreviations ..... i

*Abstract* ..... ii

CHAPTER ONE ..... 1

GENERAL INTRODUCTION ..... 1

1.1. Background of the Study ..... 1

1.2. Statement of the Problem ..... 3

1.3. Research Objectives ..... 6

1.4. Research Questions ..... 6

1.5. Scope of the Research ..... 6

1.6. Literature Review ..... 7

1.7. Research Methodology ..... 9

1.8. Significance of the Study ..... 9

CHAPTER TWO ..... 10

GENERAL OVERVIEW ABOUT *TREATY- SHOPPING* UNDER INTERNATIONAL INVESTMENT LAW ..... 10

2.1. *Treaty-shopping Defined* ..... 10

2.2. Bilateral Investment Treaties and Economic Growth ..... 11

2.3. Reasons for *Treaty-Shopping* ..... 12

2.4. Definition of Eligible Investor in BITs ..... 15

2.4.1. Nationality of Company in International Investment Law ..... 17

2.5. Grounds of *Treaty-Shopping* ..... 23

2.6. Types of *Treaty-Shopping* ..... 24

2.7. Methods of *Treaty-Shopping* ..... 25

2.8. The Controversy over Treaty-Shopping ..... 26

2.8.1. The Debates about Legality of *Treaty-Shopping* ..... 26

2.8.2. Prominent International Arbitral Cases involving *Treaty-Shopping* ..... 27

2.9. Damaging Effects of *Treaty-shopping* ..... 35

2.10. The Denial of Benefit Clause (DOB) ..... 44

CHAPTER THREE ..... 47

ISSUES OF *TREATY-SHOPPPING* UNDER ETHIOPIA'S BILATERAL INVESTMENT TREATIES 47

3.1. General Overview of Ethiopia's Bilateral Investment Treaties ..... 47

3.2. The Structure of Ethiopia's BITs ..... 48

3.3. Definition of Investor in Ethiopia's BITs ........................................ 49
3.3.1. Definition of Natural Persons ........................................ 49
3.3.2. Definition of Legal Entities ........................................ 50
3.4. Nationality of Legal Entities ........................................ 52
3.4.1. Basis of Corporate Nationality ........................................ 52
3.5. Ethiopia's BITs vis-à-vis Exposure to *Treaty-Shopping* ........................................ 55
3.6. Potential Threats to Ethiopia out of the Exposure to *Treaty-Shopping* ........................................ 58
CHAPTER FOUR ........................................ 61
CONCLUSIONS AND RECOMMENDATIONS ........................................ 61
Conclusions ........................................ 61
Recommendations ........................................ 65
Bibliography ........................................ I

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## Acronyms and Abbreviations

BIT- Bilateral Investment Agreement

COMESA - Common Market for Eastern and Southern Africa

COMESA CIAA- COMESA Common Investment Area Agreement

CSR- Corporate Social Responsibility

DOB- Denial of Benefits

FDI- Foreign Direct Investment

FET-Fair and Equitable Treatment

FPS-Full Protection and Security

ICC- International Chamber of Commerce

ICSID- International Center for Settlement of Investment Disputes

IISD-International Institute for Sustainable Development

ISDS-Investor State Dispute Settlement

LDC-Least Developed Country

MFN- Most Favored Nations

MIA- Multilateral Investment Agreement

NAFTA- North American Free Trade Agreement

NT-National Treatment

OECD- Organization for Economic Cooperation and Development

UNCITRAL- United Nations Commission for International Trade Law

UNCTAD- United Nations Conference on Trade and Development

WTO- World Trade Organization

***Abstract***

*Bilateral Investment Treaties (BITs) are agreements between two sates for reciprocal protection of investors and /or investments of one in the territory of the other. They are not thus generally meant to protect the investors of a non-contracting third sate as well as domestic investors of the parties. However, there are situations that a BIT benefits totally uncontemplated subjects i.e., the aforementioned exclusions. This is through the instrumentality of treaty-shopping. Treaty-shopping is a scenario whereby investors of a non-contracting third state or domestic investors of one of the BIT parties distract BIT benefits. Investors use such technique to exploit investment opportunities in a target host state, including its BITs. Most importantly, the Most Favored Nation (MFN) clause and the right for access to international investment arbitrations are the core protections hunted by such investors in BITs.*

*Nationality of investors in general and that of companies in particular is the central shelter of . There is no consensus among scholars as to the legitimacy and desirability of .*

*There is also no consensus in international investment arbitrations about the acceptability of practice. Yet, there are practically felt difficulties posed to host states that emanate from the scenario. Among other things,  results in the multiplicity of claims by investors in international arbitrations, parallel legal proceedings and internationalization of domestic investments. It also curtails government regulatory power and jeopardizes sustainable development in host states.*

*The aim of this study is to analyze Ethiopia's BITs vis-à-vis treaty-shopping. The researcher has used doctrinal research methodology. Primarily twenty seven BITs sighed by Ethiopia are examined in this research. Besides relevant decisions of international arbitrations, and additional secondary sources were consulted. Based on the investigation, the researcher found that, given many of the country's BITs share stark similarity BITs of other states which accommodated the problem, they are exposed to the problem, in varying degrees yet. As a proactive remedy to alleviate the situation from the very beginning, the researcher recommends for renegotiating those BITs affected by the problem.*

## CHAPTER ONE

## GENERAL INTRODUCTION

### 1.1. Background of the Study

Repeated efforts were done by the World Bank Group, the Organization for Economic Cooperation and Development (OECD) and the World Trade Organization (WTO) in different times for the creation of international investment treaty. Yet, all works remained to be unsuccessful.[1] The symbolic success is International Centre for Settlement of Investment Disputes (ICSID) was established in 1965 as a branch of the World Bank Group. This international institution is mandated to resolve investment disputes between a foreign investor and host state in the Washington Convention that sets out its functions. As a result, the treaty regime is left to BITs, which rapidly proliferated reaching three thousands since 1959 when the first BIT was signed between West Germany and Pakistan.[2]

Investment treaties have more or less similar purposes: protecting foreign investors/investments against detrimental host state measures. Investors can be natural persons or legal entities, the huge amount being carried out by the latter however.[3] Foreign investors are mostly defined based on nationality in BITs. Nationality of investors in general and that legal entities in particular constitutes one of the unsettled issues in international investment law. This posed difficulty in sorting out the scope of the protections of in BITs.[4] Traditionally, the 'incorporation' test and 'company seat' test were applied to figure out in these treaties. Through time, these tests especially the former went unable coup with new developments in international investment law, one of which is  which this work focuses on. Company nationality became as oblique as capital

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[1] *M Sornarajah* , *The International Law on Foreign Investment*, (3rd edition, Oxford University Press, Oxford, 2010) 184

[2] *Martha B* and *Tilahun E*, 'Rethinking Ethiopia's Bilateral Investment Treaties in light of Recent Developments in International Investment Arbitrations' (2014) Vol. 8 n.1 'Mizan Law Review' 117,120

[3] Suzy H. *Nikièma,* 'Best Practices: Definition of Investor' (*'The International Institute for Sustainable Development,* 2012) footnote *5* <http://www.iisd.org/pdf/2012/best_practices_definition_of_investor.pdf> accessed 10 March, 2017

[4] Ibid, n,3,1

in international trade that these tests got obsolete. This is because BITs were started to be exploited by subjects which are not intended for coverage by the parties. Consequently, nationality of companies in investment treaties became a point of dispute among scholars in the field. The controversy is also extended to international investment arbitrations giving rise to very conflicting and unpredictable rulings which rendered tribunals' jurisprudence, especially, of the ICSID unreliable.[5] This is not in overlooking that the ICSID generally does not handle investment disputes between host state and its own nationals.[6]

Providing a clear cut way of establishing company nationality became common as tribunals would normally follow rules of treaty interpretations, the Vienna Convention on Law of Treaties (VCLT signed 1969). It was thought that they would not easily contempt clear stipulations of BITs (Art. 31 of VCLT) although things have been to the reverse in several instances.

*Treaty-shopping* is diverting treaty protections by subjects which the treaty parties have not envisioned for benefiting by the treaties, BITs here after. These could be either the national of non-contracting third states to that BIT or the nationals of the target host state.  is fundamentally associated with investor nationality, especially of companies where problem is severe. The more BITs use broader definition for company nationality, the greater will be their vulnerability to cases.[7] In particular, the exclusive application of the 'incorporation' criterion is the major factor of the phenomenon.

*BIT- shopping* results in not only the exploitation of BITs benefits by the nationals and/or companies of non-contracting states, but also causes the internationalization of domestic capital.

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[5] Krivoy Yaraslau, 'Piercing Corporate Veil in International Arbitration' (2011) 'The Global Law Business Law Review' 1

[6] Article 25 (2) (b) says 'the term "national of another contracting state" means, for the purposes of Article 25(l): "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"'. The second segment of the provision thus sets out how a host state may renounce its protection of not submitting in to the tribunal by subsidiary company established within its territory because of foreign control in the entity.

[7] Roos van Os & Roeline Knottnerus, '*Dutch Bilateral Investment Treaties: A Gateway to "Treaty Shopping" for Investment Protection by Multinational Companies*' (Amsterdam: SOMO, October 2011) 11 <https://www.somo.nl/wp-content/uploads/2011/10/Dutch-Bilateral-Investment-Treaties.pdf> last accessed 17 June 2017

In such cases, host may have to encounter multiple claims and parallel arbitral proceedings in which arbitration tribunals do have disagreeing decisions.[8]

Some scholars argue that *BITs-shopping* may not be bad always, the market BITs would be *shopped* rather may significantly matter. They contend that given MFN assumes the existence of at least two foreign investors protected by different BITs, third BIT should not be a supermarket from where someone goes to buy merchandises.[9] Hence, the issue depends on the relationship between the host state and the state to which the investor claims to have a nationality. Usually, a state may not be willing to protect the investors of other states that are adversary or enemy to its welfare.

BITs are built on two underlying prophecies: one, foreign investment stimulates economic growth, and two, BIT promote the foreign investment even if this is not empirically founded. Some researches show that host state representatives signing BITs do not fully appreciate all circumstances of the treaty. This is because they say, one, these delegates do not have adequate diplomatic experience of treaty negotiations. Secondly, they are obsessive of foreign investment which make them blind of makings sound appreciation of the consequences of the agreement.[10]

This research analyzes Ethiopia's BITs in line with *treaty-shopping*. More specifically, it assesses the BITs of the country against factors the problem. In the end, it predicts what the country would face attributed to this issue and recommends way outs to escape from the problem.

### 1.2. Statement of the Problem

Ethiopia is among many developing states which has been signing massive number of BITs over the last three decades: more than thirty by now many of which have entered in to force. Looking

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[8] Peter Muchlinski, 'Corporations and the Uses of Law: International Investment Arbitration as a "Multilateral Order''', (2011) vol. no. 4 'Oñati Socio-Legal Series' 1,17

[9] Alejandro Faya, 'The MFN Clause in International Investment Agreements, A tool for Treaty Shopping?' (2008) 'Journal of International Arbitrations'90, 92

[10] Legum B, 'Defining Investment and Investor: Who is Entitled to Claim?" presentation at the Symposium "Making the Most of International Investment Agreements: A Common Agenda" co-organized by ICSID, OECD and UNCTAD, 12 December 2005, Paris

into nationality of companies in the BITs,[11] one comprehends that the clauses of many of the BITs are inconsistent one another and very unrestrictive.

Out of twenty seven BITs used in this work, twenty six apply the incorporation test. These BITs exhibit differences in the terms they used[12] and in the application of the criterion.[13] The BITs signed with Austria[14], Netherlands[15], the *UK*[16] and Tunisia define company nationality on the basis of the laws of the state in pursuance of which the company is incorporated. On the other hand, the BITs signed with France and Algeria use the cumulative of the laws and territory of the company's home state.[17] Some of these BITs use the incorporation criterion exclusively while others supplement it with other tests, mainly the company seat and economic engagement criteria. These BITs demonstrate how the incorporation criterion is defined in dissimilar ways.

The place of company seat is the second most used company nationality criterion in Ethiopia's BITs. The treaty signed between Ethiopia and Germany uses this test exclusively. Otherwise, the company seat criterion is used in combination with others, often the incorporation test.[18] There is still inconsistency among the BITs on how this criterion is established. The BITs haphazardly

[11] For the purpose of this research, the term *"company*" is construed beyond the strict sense of those characteristics distinguishing company from other business organizations. It denote all business organizations the liabilities of which are limited to their assets, irrespective of their legal personality and purpose.

[12] Provisions are articulated using the terms such as constituted, duly organized, or incorporated interchangeably to entail company establishment based on the laws of the home state, within or out of the territory of that state to which nationality is attached to.

[13] The treaties use incorporation on the basis of territory and/or laws in pursuance of which the company is established. They also use terms like constitution, incorporation, due organization alternatively.

[14] Agreement between the Republic of Austria and the Federal Democratic Republic of Ethiopia for the Promotion and Protection of Investments (signed 4 June 2004), Art. 1 (b)

[15] Agreement on encouragement and reciprocal protection of investments between the Federal Democratic Republic of Ethiopia and the Kingdom of the Netherlands (signed 16 May 2003), Art. 1 (c) (ii)

[16] Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Federal Democratic Republic of Ethiopia for the Promotion and Protection of Investments ( signed 19 November 2009), Art. 1 (c) (ii)

[17] Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Democratic Republic of Algeria on the Reciprocal Promotion and Protection of Investments (signed 4 June 2004), Art. 1 (2)(b); Agreement between the Government of the Federal Republic of Ethiopia and the Government of the Republic of France for the Reciprocal Promotion and Protection of Investment (signed 25 June 2003), Art. 1(3)

[18] Treaty between the Federal Republic of Germany and the Federal Democratic Republic of Ethiopia concerning the Encouragement and Reciprocal Protection of Investments (signed 19 January 2004), Art 1(3)

use head office[19], headquarters[20], registered office[21], domicile[22], seat[23], principal place of business, central or practical place of administration etc. to designate company seat.

The ownership/control test is used the least and it has never been applied to define home grown companies of BITs parties in any of the treaties except this is done in Ethio-Iranian BIT that it's applied as alternative to economic engagement test.[24] In other few BITs, the control/ownership test is applied in respect of overseas companies owned or controlled by the BITs parties.

Lastly, fourteen of the BITs put economic engagement by the company in the territory of the other BIT party as a precondition to claim nationality of the latter. However, a big difference exists in these treaties regarding the degree of economic activities by companies in the territory of BIT parties. Some make the link with no specification as to the extent of the business activities by the company at hand while others particularize the scale of the economic the engagements in that state. Nevertheless, there is no objective standard of determining the scale of economic undertaking in the BITs which broadens the definition through expansive interpretations.

From the joint understanding of all the above facts, it's possible to perceive that Ethiopia's BITs are greatly dominated by the incorporation criterion in defining company nationality. There is inconsistency as to the establishment as well as the application of the criterion across the BITs. Except the Ethio-Austrian BIT, none of the treaties apply the 'Denial of Benefits' clause . All these factors combined lay the countries BITs open to *treaty-shopping*. As a result of this

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[19]Ethio-Algerian BIT, n, 17, Art. 1 (2) (b)

[20]Agreement between the Republic of Turkey and the Federal Democratic Republic of Ethiopia Concerning the Reciprocal Promotion and Protection of Investments (signed 16 Nov 2000), Art. 1 (1) (b)

[21] Agreement between the Belgian Luxembourg Economic Union and the Federal Democratic Republic of Ethiopia on the Reciprocal Promotion and Protection of Investments (signed 26 Oct 2006), Art.1 (b)

[22]Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investments (signed 11 May 19998), Art.1 (2) (b)

[23]Agreement between the Government of the Republic of Equatorial Guinea and the Government of the Federal Democratic Republic of Ethiopia on the Reciprocal Promotion and Protection of Investments (signed 11 June 2009), Art.1(2) (b)

[24]Agreement on Reciprocal Promotion and Protection of Investments between the Government of the Federal Republic of Ethiopia and the Government of the Islamic Republic of Iran (signed 21 Oct 2003), Art.1 (2)

shortcomings, the treaties could cause crisis on the country's investment regime in the future from many stand points.

### 1.3. Research Objectives

The objective of this research is to scrutinize BITs of Ethiopia in light of *treaty-shopping*. In this respect, it addresses the lacuna in the BITs signed by the country rendering them to benefit subjects not contemplated, and those damaging consequences attributed thereto. Specifically, it aims to:

- highlight the concept of *treaty-shopping* in in international investment law;
- indicate the modality of treaty-shopping ;
- show the major gaps in Ethiopia's BITs to be vulnerable to the problem;
- demonstrate apparent risks which the country potentially faces from the problem;
- recommend solutions to address the risks in the existing BITs and fore coming treaties.

### 1.4. Research Questions

1. What is the concept of *treaty-shop*ping in international investment law?
2. What are the causes and different versions of the problem?
3. What are the main consequences attributed to on host state's foreign investment objectives?
4. What are the major factors in the BITs of Ethiopia to be exposed to ?
5. What are the apparent consequences flowing from such shortcomings in the investment treaties of the country?

### 1.5. Scope of the Research

*Treaty-shopping* can be done by both natural persons and legal entities, companies in particular. Basically, it is natural persons who are the mastermind behind in both cases. Yet, the problem is more frequent, multifaceted and more complex with corresponding impacts in the latter. This work also does not pledge to discuss the phenomenon in relation to all legal entities. It rather explores Ethiopia's BITs vis-à-vis with respect to companies in conventional context of the term in legal scholarship.

### 1.6. Literature Review

The researcher has exerted unreserved efforts to reach into existing writings, apart from those literatures used in the forgoing pages. Convictions are paid to look into the works of scholars on related issues, even not in strict sense of the concept of *treaty-shopping*. However, so far, only a single publication is available in the internet as far as BITs of Ethiopia are concerned.[25]. It's a journal article by *Martha Belete* and *Tilahun Esmael* in the *Mizan* Law Review. This work explores the country's BITs in light of recent developments in international investment arbitrations, most particularly, the MFN treatment. The authors recognize that the BITs signed by Ethiopia so far are open to *treaty-shopping* risks because of their broader and confusing definition of the MFN. They stress that great majority of the country's BITs are ambivalent and incoherent on whether the MFN includes dispute resolving procedures between a foreign a protected investor and the country. The writers have also underscored that, there is wide range of inconsistency among the decisions of international investment arbitrations. They put this problem persists even in different awards of the same arbitral tribunal in different times regarding the interpretation of the MFN clause in investment treaties.

The researcher believes that the work has profound significance for this study. However, given the MFN clause is not all about access to international arbitrations, the authors have not given emphasis to other grounds in which it could be invoked. Moreover, the authors discussed how the MFN would be diverted to include procedural issues in BITs by investors from BIT friends of Ethiopia. They didn't discuss about how the same claim could be invoked by investors the actual home states of which do not have any BITs with Ethiopia. This research tries to fill these gaps left by these authors.

Secondly, the researcher has looked in to *Suzy H. Nikièma's* work entitled as *'Best Practices: Definition of Investor'*[26] which is tremendously relevant to this study. The writer sets out that the nationality link is so fundamental for delimitations of the treatment of investors and investment in BITs. Furthermore, the work puts BITs are actually not signed with advance identification of investors by name in host states. Rather, the article states, they are just podiums between the

[25] *Martha* and *Tilahun* , n, 2

[26] *Nikièma* , n, 3

parties when the former wish to mobilize capitals from one the other. Beyond this the author says, BITs have both positive and negative implications: they are permissive or guarantors for the investors of one party in the territory of the other. Meanwhile, they are also denials with respect to investors from none signatory states.

Additionally, *Nikièma*'s puts that the more a country has so many BITs, the greater would be the risks associated with defining investors. In the end the writer argues, this causes chaos with short term and long term consequences.

A look at has also be done to "Corporations and the use of law: International Arbitration as Multilateral Legal order" written by Peter *Muchlinski.* This article, citing the work of a prominent scholar, *Schill S.W.,* claims that corporate structuring has become a challenge to nationality as a criterion to limit the scope of a BIT benefits to specific nationality investors, almost rendering it not to function entirely. This is because he argues, nationality of corporate investors has become incontrollable. He adds, multinationals investors will penetrate in to a BIT benefits by setting up a *shell-companies (mail-box companies)* with series of chains and multi jurisdictions. He then claims, with his own words quoting *Schill* "Ultimately, BIT protection is less a question of the investor's nationality, but rather a question of whether an investment is structured in a specific way"[27] that shows the technicality of the problem. *Muchlinski* also signifies the flaw of corporate nationality to define investors in BITs criticizing the ICSID in its assumption jurisdiction in the *Tokios Tokles* case.[28]

Finally, the author underlines, *BITs-shopping* may be effective when it's seen from the corporate's efficiency perspective. Yet he says, it poses substantial danger to the host state's

[27] *Muchlinski* , n, 8, 20

[28] *Tokios Tokelės v Ukraine*, (2004) Decision on Jurisdiction, ICSID, Case No. ARB/02/18, (2004). This is a case between *Tokios Tokles*, a company incorporated in and in accordance with the laws of Lithuania, but 99% of its shares as well as management was controlled by Ukrainian nationals. The complainant sued Ukraine in relation to alleged measures taken by the respondent against its subsidiary, Taki Spravi established in Ukraine. Ukraine objected the jurisdiction of ICSID on the ground that the company is legally a Ukrainian as it's owned and controlled by its own national and the tribunal's decision to see the case destroys the very purpose of the ICSID. Nevertheless, this argument was not accepted by the panel. The President of the panel, Professor Prosper Weil resigned from the panel criticizing the tribunal's decision to see the case was erroneous and goes against the purpose of the ICSID Convention. He stated that nationality of legal entities must be carefully scrutinized beyond its traditional conception in the fear of undesirable consequences for host states when the jurisdiction of the tribunal is established.

investment welfare in many ways. Similar to the two works above, *Muchlinski* recognizes the prevalence of inconsistency in the international arbitral awards on the subject matter. He says, such inconsistencies were in cases of considerably similar set facts that requires curiosity about the problem during BITs negotiation.

The researcher believes these articles are not comprehensive enough to have a complete picture of the *treaty-shopping*. First, though nationality of companies is the main curtain behind the phenomenon, the works did not sufficiently discuss the strength and weakness of each corporate nationality criterion in respect of the problem. Besides, they did not fully address modality of *treaty-shopping* in international investment law, nor are they adequate about the potential threats of the issue.

### 1.7. Research Methodology

The researcher employed doctrinal research methodology. To this end primary and secondary sources are extensively used. The country has signed thirty two BITs twenty seven which are used in this research. Additionally, books and journal articles related to the area are extensively used as far as they are relevant for this work. Besides, prominent decisions of different international investment arbitrations, fundamentally the awards of ICSID and United Nations Commission on International trade law (UNCITRAL) arbitration center on the issue are referred. In addition, the researcher also visited existing best practices of some states in preventing or mitigating the *BITs- shopping*.

### 1.8. Significance of the Study

Most of the country's BITs have either expired or closer to expiring times since they were signed in the late 1990s and the first 2000s. Hence, this research will contribution for policy makers to consider the issue and alleviate the problem. The work is also important to those in the academic and research centers to have insights about the issue and conduct further studies.

## CHAPTER TWO

## GENERAL OVERVIEW ABOUT *TREATY- SHOPPING* UNDER INTERNATIONAL INVESTMENT LAW

### 2.1. *Treaty-shopping Defined*

The beneficiaries of an investment agreement between two states are not known to BIT parties in advance, but they are set to be identifiable in times of admission by either state. For this purpose, the criteria of identifying[29] such investors is stipulated in the treaty, almost always, the nationality of the latter. A state may have its own policy objectives to favor the investors of a certain origin from the others. The basic ground by which two states negotiate BITs.

BITs are commitments by sates for reciprocal treatments of investors and investments by nationals/companies of one in the territory of the other. Theoretically, it's very uncommon for two states sign a BIT such that only one carries the burden of protections without reciprocal obligations on the part of the other. Besides, it's hardly possible for a state to sign investment treaties with others from which it does not invite investors in to its territory.

T*reaty shopping*[30] represents a conduct of foreign investors of who deliberately seek to obtain the benefits of an investment treaty in a certain target host state without their actual nationality state having investment treaty with the former. It could also be done by the nationals of the host state itself. Investors achieve such goal by structuring their investments in or bringing claims from third countries that have more favorable treaty terms with the target host state.[31] As said earlier, investment treaties impose reciprocal obligations on signatories. This implies the partners are not willing to protect investors from non-contracting sates. Otherwise, it makes no difference whether the treaties exist or not in the first place. Furthermore, states would not be normally willing to protect their own nationals in their own territory by such treaty. *Treaty- shopping*

[29] *Suzy H. Nikièma* 'Best Practices: Definition of Investor' (*The International Institute for Sustainable Development*, 2012) 1 <http://www.iisd.org/pdf/2012/best_practices_definition_of_investor.pdf> accessed June 12 2017

[30] Literatures use treaty shopping, nationality planning and nationality of convenience interchangeably.

[31] Matthew Skinner, et.al. 'Access and Advantage in Investor-State Arbitration: The Law and Practice of Treaty Shopping' (2010) Vol. no. 3 'Journal of World Energy Law and Business' 260

hence distorts such consent of states which leads investment treaties to benefit an unintended subjects.[32]

## 2.2. Bilateral Investment Treaties and Economic Growth

International investment law is a body of rules that regulates investment relationships between states. It governs the treatment of foreign investor and its investment in the territory of host states. Like public international law, treaties form the largest sources of international investment law. Yet there is no uniform international investment treaty regime. Series of efforts by the World Bank and the OECD for the creation of the regime failed in different times. As a result, the treaty system is dominated by few multilateral treaty arrangements, but thousands of BITs affecting many states. The proliferation of BITs has increased since the end of the Second World War.[33]

BITs have become the vehicles in the development of the international investment law. Since the establishment of the ICSID, it has been the goal of many developed states to have single international investment treaty. Developing capital-importing states opposed the formation of such an agreement, as well as the principles on which it would be formulated[34]. Following the ICSID, a lot number of BITs are signed affecting more than hundred and seventy states all over the world. Hence, one can safely say BITs become the heart of international investment treaty regime these days.

BITs have generous assurances to protect investments on foreign soil from undue impairments by host state such as unlawful expropriations and discriminatory treatments. Among those protections granted to foreign investors also includes the right to recourse in to international arbitrations should a dispute arise between the host state and the investor out of the investment at hand.[35] Such right is not available to domestic investors. This is clearly stated under the ICSID

[32]Aaron Wanyana , ‘Curbing 'treaty shopping': the 'beneficial ownership' provision analyzed from a South African perspective’ (2007) Vol. no. 2 ‘The Comparative and International Law Journal of Southern Africa’ 237

[33]Aleksandrs Fillers , ‘Corporate Nationality in International Investment Law’ (2014) Vol.no.1 ‘European Scientific Journal’ 50

[34] Skinner et.al. (2010) n, 31, 276

[35]Fillers, Ibid 51

Convention.[36] Yet, it's up to the discretion of the host state to grant such right to foreign owned subsidiaries.[37]

There is no consensus about the relationship between investment treaties and the inflow of foreign direct investment. Studies reach in to contradicting outcomes in support and antagonizing direct relationship between the two. Currently, over three thousand BITs are signed worldwide. Amazingly, few states have signed no BITs,[38] whereas Brazil has no BIT which has entered in to force. This is crystal evidence for some commentators who disprove the old professed thought as to the interdependence of investment treaties and FDI. For example, Brazil has been the largest recipient of FDI in the region between 1985 and 2012 without having a single working BIT pursuant to UNCTAD research.[39] The UNCTAD report then warned developing states to be cautious of investment treaties and focus on other issues of priorities to attract the inflow of FDI.[40]

### 2.3. Reasons for *Treaty-Shopping*

Investors pursue the BIT which most guarantees their interests from many BITs and an investor normally will have at least one involving its target host state. Based on this, the existence of many BITs mounts the risk of investors' preferences and increases the problem of *treaty-shopping*. Through this, a BIT signed between states 'A' and 'B' will be stretched to nationals of state 'C'. The latter access the 'A'-'B' BIT by getting the nationality of either 'A' or 'B'. Though investors channel their investments to get the best nationality on such grounds, the reasons for doing so are multifaceted. These include both substantive and procedural matters. In the first case, it's to get those treatments, mostly the MFN and national treatment where as in the second, for getting access to international investment arbitrations.

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[36] ICSID Convention, (signed in 1965), Article 25 (1)

[37]Ibid

[38]Monaco, Andorra, Liechtenstein, and North Korea have signed no BIT.

[39]Thomas Fritz, 'International Investment Agreements under Scrutiny: Bilateral Investment Treaties' (*EU Investment Policy and International Development*, 2015) 10 <http://www.s2bnetwork.org/wp-content/uploads/2015/03/IIAs-report-Feb-2015-2.pdf> accessed 29 March 2017

[40]UNCTAD Trade and Development Report, *'Global Governance and Policy Space for Development, 2014*, New York/Geneva) 159 <http://unctad.org/en/PublicationsLibrary/tdr2014_en.pdf> accessed 23 April 32017

The classical meaning of MFN clause indicates, the standard seeks to accord the investors of one state not less favorable treatment than which the host state does to investors of any other states.[41] Once a state enters in to investment treaty having MFN, it has agreed not to discriminate among investors all states in BITs network. Thus MFN functions like a 'one-way ratchet' such that, instead of renegotiating many BITs again and again, a state simply signs a single BIT having better protections. Through the operation of MFN, the benefits in such BIT will automatically apply to investors protected by other BITs to which this state is a party to.[42] This is yet when all the other BITs have MFN clause.

The interpretation of the MFN clause is significantly disputed, which complicated the efforts of preventing *treaty-shopping*. The decisions of international investment arbitration tribunals in general and the ICSID in particular reveal much contradictions. The source of such controversy is because of none uniformity as to the meaning of the standard of this treatment. From various rulings of these bodies, it's hard to figure out whether the clause is limited to substantive rights, or it also embraces procedural issues. Tribunals gave incompatible decisions for similar set of facts. This inconsistency has increased the prevalence of *treaty-shopping* as this standard of treatment is the best tool through which the most investor friendly BIT is taken advantages of.

Five arbitrations conducted in the ICSID show the scale of uncertainty as to future decisions concerning the issue. The ICSID has reached in to sharply divergent decisions in these *Maffezini v Spain*[43] , *Siemens A.G. v The Republic of Argentina*[44], *Salini Constructions S.p.A. v Jordan,*[45] *Plama Constructions v Bulgaria*[46] *and Gas Natural SDG v Republic of Argentina*[47]. The *Maffezini* case is mentioned by several literatures to directly address whether an MFN clause in a certain BIT imports dispute settlement mechanisms from another BIT. In this case, ICSID stated

[41]Aaron M. Chandler A, 'BITs, 'MFN Treatment and the PRC: The Impact of China's Ever-Evolving Bilateral Investment Treaty Practice' (2009) vol.no.43 'The International Lawyer' 1301, 1302

[42] Ibid 1310

[43]Decision on jurisdiction, ICSID, Case No. ARB/97/7

[44] Decision on Jurisdiction, ICSID, Case No. ARB/02/8

[45]Decision on Jurisdiction, ICSID, Case No. ARB/02/13, 573

[46] Decision of the Tribunal on Preliminary Questions on Jurisdiction, ICSID, Case No. ARB/03/24

[47] Decision on Jurisdiction, ICSID, Case No. ARB/03/10

"unless it appears clearly that the state parties to a BIT or the parties to a particular investment agreement settled on a different method for resolution of disputes that may arise, MFN provisions in BITs should be understood to be applicable to dispute settlement'."[48] From this statement, it's obvious that failure to clearly exclude dispute settlement from BIT coverage means the MFN also embodies procedural rights. In this case, Spain argued that the Argentina-Spain BIT, which protected the investor was not agreed in the intention of extending MFN to include procedural rights. Art IV, para 2 of the Argentina–Spain BIT reads "In all matters subject to this agreement, this treatment shall not be less favorable than that extended by each Party to the investments made in its territory by investors of a third country. [49] It's using such generality of phrases in this provision that the complainant supported its claim for invoking more favorable dispute settlement mechanism from other BIT between the respondent and other partner. ICSID ruled similar to the *Maffezini* in the *Siemens* v *Argentina,*[50] *Tecmed* v *Mexico*[51] and *Gas Natural SDG v the Argentine.*[52]

The same tribunal, in *Plama* case demonstrated the opposite of the *Maffezini* ruling choosing narrow interpretation of MFN clause. It said, when a BIT is silent as to the settlement of investor-state dispute or the MFN is narrower in its essence, one cannot reason *a contrario* that MFN also embodies procedural rights. Instated it furthered, the intention to incorporate dispute settlement provisions must be clearly stated and unambiguously expressed.[53] ICSID also chose similar break away from the *Maffezini* in *Salini Construction v Jordan* in adherence to narrower meaning.

The controversy over the MFN is also extended to umbrella clause. This confusion lies on the relationship between MFN and umbrella clause. Umbrella clauses are provisions through which

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[48] *Maffezini* , n, 43

[49] Surya P Subedi , *International Investment Law Reconciling Policy and Principle* (Oxford and Portland, Oregon, 2008) 69, footnote no.4

[50] *Siemens AG* , n, 44

[51] T*ecnicas Medioambientales Tecmed SA v The United Mexican States*, (2003) Award, ICSID, Case No ARB (AF)/00/2, (2003)

[52] *Gas Natural SDG* case , n, 47*,* pars.19–20

[53] *Plama Construction* case (2005), cited in *Subedi*, n, 49, 70

the contracting states in the treaty agree to accord additional substantive and/or procedural rights to the investors of each other which as are set forth in investor state contract. Thus, when a BIT contains umbrella clause, breach of investment contract by the host state against an investor of the other treaty party amounts to breach of treaty. This means, the umbrella clause creates extraneous obligations on the host state apart from those obligations agreed in the BIT.[54]

Broad definition of the MFN in BITs was used by investors as a tool to invoke umbrella clauses from another treaty between the host state and third states. This right was claimed even if the umbrella clause does not exist in the BIT between the host sate and the home state of the investor. The decision of tribunals in this respect is another area of uncertainty in international investment law. For example, in EDF International S.A. et.al *versus* Argentina,[55] the French investor invoked MFN contained in the Argentina-France BIT in order to benefit from the protection of umbrella clauses found in the BITs between Argentina and Belgian Luxembourg Economic Union as well as Argentina and Germany, in which the tribunal decided in the affirmative. In another case, *Salini Construction v Jordan,*[56] the claimant tried to import an umbrella clause from a BIT between the respondent and Italy. The tribunal however rejected request for jurisdiction stating the subject matter is contractual and not investment dispute.

All these inconsistencies in the ICSID truly show how the interpretation of MFN clause is so fluid which makes reliance on the jurisprudence of the ICSID unsafe. From these cases, it's worth of spotting the vitality of demarcating substantive-procedural aspects of the MFN in BITs.

### 2.4. Definition of Eligible Investor in BITs

Definition of investor and investment in BITs is the central issue in international investment law strongly interconnected to *treaty-shopping*. By definition of investor in BITs, it's meant to specify the envisaged beneficiaries of the BIT protections. Nationality of investor is the basics in

[54] Stephan W Schill, *The Multilateralization of International Investment Law* (Cambridge University Press 2009) 84, cited by Martha Belete and Tilahun Isamel, 'Rethinking Ethiopia's Bilateral Invetment Treaties in light of Recent Developments in International Investment Arbitrations' (2014) Vol. 8 no.1 'Mizan Law Review'138

[55] *EDF International S.A, SAUR International S.A. and Leon Participaciones Argentinas S.A. V. Argentine Republic*, (2012), ICSID, Case No. ARB/03/23, cited in, Martha Belete and Tilahun Isamel (2014) n,237 138

[56] See *Salini Costruttori S.p.A. and Italstrade S.p.A. and Italstrade S.p.A v. The Kingdom of Jordan, (2004)*, Decision on Jurisdiction, ICSID, Case No. ARB/02/13

defining investor in investment treaties so far.[57] Nationality of investors distinguishes those subjects in the respective treaty which the negotiating states intend to protect in from those the guarantees do not extend to. The latter in other words are exclusions, usually investors of non-contracting states and domestic investors of each state in its territory.

Nationality of natural persons is left to each state to determine in accordance of its domestic legislations. Some investment treaties recognize other additional criteria, such as residence or domicile as parameter to establish the definition of natural persons. Nationality of companies on the other hand is determined based what the negotiating parties agreed on. Nationality of companies is not as easy as that of physical persons due to the force of globalization. Recently, companies became as fungible as capital that they are not restricted to a single jurisdiction which made their oblique.[58]

International investment arbitrations have usually have been stick to the incorporation or company seat when they faced issues of nationality. This is because many BITs employ the incorporation and seat of business[59] independently or in combination as criteria to trace corporate nationality. In that case, tribunals showed their convictions to preserve treaty languages. Nevertheless, this led to strange results: investment treaties began to be abused by subjects which the contracting parties might not want to protect. Subsequently, these nationality criteria faced growing criticism as unable to establish company nationality. There started to pierce the corporate veil to reach in to the actual owners, using the control/ownership and economic engagement criteria. Nevertheless, the last criterion is not repeatedly discussed by literatures as independent basis of corporate nationality. It's mostly used to supplement the basic there tests rather.

The definition of investor in BITs constitutes one of the core issues alongside other substantive and procedural matters in international investment law.[60] This is because countries have their

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[57]Christoph Schreuer, 'Investments, International Protections' (2011) <http://www.univie.ac.at/intlaw/wordpress/pdf/investments_Int_Protection.pdf> accessed 12 April 2017

[58] OECD, 'Definition of Investor and Investment in International Investment Agreements' (2008) 7, 8, <https://www.oecd.org/investment/internationalinvestmentagreements/40471468.pdf> accessed 12 April 2017

[59] Ibid

[60]OECD , n,58, 7

respective policy considerations and investment objectives. Such objective are also reflected in giving protections to the investors of certain states and denying to others'. Hence, it's very critical to delimit what types of investors are covered under investment treaties together with the criteria of identifying them other investors from all around the world.[61]

Defining eligible investors is significant from the viewpoint of three parties in international investment: the capital exporting state, the capital importing state and the investors. From the side of the first, it enables to identify investors in the host state which would be protected by the agreement with the latter. More importantly, investor's guarantee for the MFN clause if any and recourse in to neutral international investment arbitration mechanisms become bold in this respect. From the part of the host state, it enables to identify which investors to attract and protect in the basic treaty. And from the part of the investor, it helps to decide how to structure its investments so that it gets the best treaty protections.[62]

### 2.4.1. Nationality of Company in International Investment Law

To begin with, nationality of investors in general and companies in particular has been a cause for varied applications of investment treaties. This is because there is no one fits-to-all standard on the subject matter. To this end, the issue has become a point of intense debate including in international investment arbitrations which gave rise to inconsistent and conflicting practices.

Generally, there are three major tests of determining corporate nationality in investment treaties. These are "place of organization/incorporation", the "place of company seat the *(siége social)"* and "ownership/control". States apply these links depending on their investment policy objectives.[63] Its' worth of noticing that each test has its own strength and weakness which makes the possibility of selecting one not easy. Many investment treaties also apply the combination of

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[61]United Nations Conference on Trade and Development, 'Definition and Scope, 2011) 'UNCTAD Series on Issues in International Investment Agreements II' '*United Nations, New Yok and Geneva*, 13

[62] Legum Barton, 'Defining Investment and Investor: Who is Entitled to Claim?" presentation at the Symposium "Making the Most of International Investment Agreements: A Common Agenda" co-organized by ICSID, OECD and UNCTAD, 12 December 2005, Paris

[63]Valts Nerets, 'Nationality of Investors in ICSID Arbitration, (Masters' Thesis, Riga School of Law, 2011) 21

the three criteria at a time. The next paragraphs are reserved to make brief explanation of these tests.

**Place of Organization/Incorporation**

The incorporation test is more common in first and second generation BITs, those signed prior to 1990s. In this criterion, a company takes the nationality of the state in accordance of the laws and place of which it's incorporated or duly organized. However some investment treaties use the place of incorporation or laws of incorporations exclusively. This in effect means a company may be established on the soil of a certain state, but in accordance with the laws of another state. Nevertheless, many cases show the two are from the same state that place of incorporation is cumulatively used with laws of such country than not.[64] The incorporation test is very broad in a sense that it does not require the company to create a genuine economic link with the state; nor it considers the nationality of owners or controllers of the entity.[65] This test is more transparent as well as less sophisticated than the rest approaches. This is as it just easily could be reached at by seeing the place of registering the articles of the association of the company.

The incorporation approach is consistent with the ICJ decision in the *Barcelona Traction* Case.[66] It is also frequently applied in many investment treaties[67] and echoed in investor state arbitrations.[68] Besides, it also respects treaty languages as it makes no reference in to undisclosed intentions of the contracting states in investment treaties. For this reason, it favors investors of all kind other than the domestic investors the host state.

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[64] OECD, n, 55, 20

[65]Fillers, n, 33, 52

[66]One of the main outcomes in Tokios Tokles case is the separation of the rights of a company from its shareholders. The ICJ made clear that "no doubt, the interests of the aggrieved are affected, but not their rights. Thus whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered the same wrong, it is only one entity whose rights have been infringed." see *Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belgium*v. *Spain)(5 Feb 1970)*(ICJ), 35, Par.44

[67] See the Energy Charter Treaty

[68] see *Hulley Enterprises Ltd v Russian Federation*, (2009), Interim Award on Jurisdiction and Admissibility, PCA Case No AA 226, P. 30; *Rompetrol Group NV v Romania*, (2008), Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, ICSID Case No ARB/06/3, pp. 23-37.

The incorporation test however is strongly criticized as it allows a large number of companies to benefit from BITs protections. This is because it does not take other factors in to account except the laws of the state the company is established in accordance of. It favors investors of all nationality including the host state. These investors could be either the companies of the host state or non-contracting third states. The companies do that by incorporating a company in another state which has investment treaty with the host state.[69] In worst cases, the incorporation test benefits companies of a state which has hostile or adverse economic and political relationships with the host state.

International arbitration tribunals have very conflicting awards on this issue. Corporate nationality was heated in the *Tokios Tokeles* case. This case was the first substantive controversy with respect to the jurisprudence of *treaty-shopping* in BITs.[70] The dispute was between, a company incorporated on the land and in accordance with the laws of Lithuania as a claimant, and Ukraine as a respondent. The claimant initiated the arbitral proceeding in the ICSID in relation to its investment activities in Ukraine.[71] In the first phase of the proceeding, the tribunal faced a difficulty on the matter of determining whether the claimant qualifies to be foreign investor in the BIT between the two states. This was after the respondent's objection on jurisdiction arguing that the super majority share (ninety nine percent) of which of the company were owned by its national. What made the tribunal's job difficult in this respect was the incorporation test was used as the only criterion to establish nationality of a foreign company in the Ukraine-Lithuanian BIT. On its objection to the tribunal's jurisdiction, Ukraine asserted that the dispute before the tribunal was an example of a party attempting to use a BIT to arbitrate against its home state, a position strictly at odds with the international character of BITs and the ICSID Convention. After careful investigations of facts and the basic treaty, the tribunal preserved the treaty language and declined Ukraine's objection. It stated that, the fact that the company is owned or controlled by the citizens of Ukraine is irrelevant for the nationality of the

[69]United Nations Conference on Trade and Development, 'Definition and Scope' (2011) UNCTAD Series on Issues in International Investment Agreements II, United Nations, New York and Geneva, <http://unctad.org/en/Docs/diaeia20102_en.pdf>

[70] Skinner et al. (2010), n, 31

[71] *Tokios Tokeles* v *Ukraine*, (2004), Decision on Jurisdiction, ICSID, Case No ARB/02/18

company in the respective BIT.[72] The tribunal ruled with two-to-one majority vote, the President, Professor Prosper Weil dissenting by protest. In his nonconforming explanation, Professor Weil stated that the origin of capital was relevant and even decisive to the question of whether the claimant was a foreign investor.[73]

Subsequent ICSID arbitrations disposed cases in the same line of interpretation. They stood in supporting the decision in situations when a company is controlled by citizens/companies of non-contracting third state to a BIT. In other words, they assumed jurisdiction despite fierce objection by respondent states where the ultimate parent company is incorporated in third state. Tribunals expressed that the nationality of the controller is not decisive to determine the nationality of the parent company if the incorporation test has to work in the basic treaty to determine nationality.[74] Cases include *Saluka Investment B.V v Czech Republic*,[75] *Waste Management v Mexico*[76] and *Autopista v Venezuela* cases.[77] A brief summary of these cases is provided in the following couple of paragraphs.

The ICSID rejected objections as to its jurisdiction by respondent states in the *Waste Management v Mexico, Autopista* v Venezuela, *Rompetrol v Romania* and *Rumeli* v *Kazakhstan* cases on the ground of nationality. In the first, a US company, Waste Management, took legal action in to the tribunal on the ground of expropriation measures taken by the Mexican government invoking the NAFTA deal. Mexico objected the jurisdiction of the tribunal on the fact that the US subsidiary in Mexico is owned and controlled by two corporations from a non-contracting party, Cayman Island. The tribunal stated that, NAFTA is not strictly fixed to contracting parties and the nationality of intermediate company is not relevant to determine the nationality of the subsidiary.

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[72] *TokiosTokles* v *Ukraine*, (2004), Decision on Jurisdiction, ICSID Case No ARB/02/18, p.29

[73]*TokiosTokles* v *Ukraine,* n 72

[74] See *SOABI v. Senegal*, ICSID Case ARB/82/1, Decision on Jurisdiction, 1 August 1984 (2 *ICSID Reports* 175), pp. 182–183

[75] See *Saluka Investment B.V v. Czech Republic*, (2006), Partial Award, UNCITRAL

[76] *Waste Management v. Mexico*, (20004) Award, ICSID, Case No. ARB (AF)/00/3, Award, paras. 77, 80

[77]*Autopista v. Venezuela*, (2001), Decision on Jurisdiction, ICSID, Case No. ARB/00/5

Almost in similar fashion, in the *Autopista* case, the tribunal held that, the nationality of directly controlling company does not affect the nationality of the holding company in respect of its subsidiary in a contracting party. In this case, the tribunal stressed that, when such fact is known to the host state and incorporation is the test for nationality in the respective BIT, subsequent transfer of shares from the subsidiary to the intermediate parent is not dangerous to the host state, nor could be a ground for the tribunal to decline jurisdiction.[78]

ICSID also made similar statements in *Rompetrol* v *Romania* regarding the nationality of controller cannot jeopardize the nationality of a foreign company when incorporation is the test for determining nationality. It further put, there is no need to inquire in to control based "effective link" test in such circumstances keeping the *Barcelona Traction* Case.[79]

In all the cases, ICSID reflected when the nationality of company from in a contracting party is determined by the incorporation test, the fact that the latter is controlled by a company from a non-contracting state is not relevant at all. Similarly, the fact that, the parent company abroad is owned by nationals of the respondent state does not affect the nationality of the parent company as is specified in the BIT, nor it affects the jurisdiction of the tribunal. This paved the way for investors to structure their investments in order for taking advantages of a nominal home jurisdiction that has a best protective BIT with other states, shortly stated, *treaty-shopping*.

In the contrary, a case between *TSA Spectrum de Argentina S.A.,* a Dutch Company but owned and controlled by citizens of Argentina, and Argentina Republic the tribunal held that, though the claimant is incorporated in accordance with laws of Belgium,[80] it was actually an Argentine company. For such reason, the tribunal declined jurisdiction.[81] These cases reflect lack of uniformity in tribunals on the issue of piercing the corporate veil. And this evidently shows, countries need to determine the nationality of corporations clearly in their treaty agreement to minimize arbitrary rulings of arbitration tribunals.

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[78]Autopista case, n, 77

[79]*Rompetrol* case, n, 66, par 7

[80] The claimant used the Belgium-Argentina BIT.

[81]*TSA Spectrum de Argentina S.A. v Argentine Republic*, (2008), Award, ICSID, Case No. ARB/05/5, paras. 114-162

**State of Company Seat *(siége social)***

The second parameter of company nationality in a lot number of BITs is the company seat test *(siége social)*. According to this approach, a company retains the nationality of the state where its office is located. The BIT between Ethiopia and Germany takes this model of corporate nationality.[82] In most cases, place of company seat is a place where the substantial management activities of the company take place, such as the meeting of the board of directors.[83] Hence, it creates more effective link between home state and the company than the incorporation criterion. This test is vulnerable to nationality claims by the so called "*mail-box*" companies. By *mail-box* company, it's to refer a company which establish an office, perhaps only postal address in a given state, for the sole purpose of getting nationality without having strong attachment there with. This nationality in the case of *treaty-shopping* is chosen aiming the best protective in a target host state.

Since it's very easy for a company to remove its head office from a state to another, this standard is not permanent compared to that of the incorporation and rarely used exclusively.

**State of Ownership/Control**

The third approach is known as state of ownership or control test. In this approach, the nationality of a company will be established by looking in to the nationality of owners or controllers. But the concept of what constitutes control is not as easy as it appears to be. The existence of control is a technical issue which requires the examination of several factors such as equity participation, voting rights and participation in decision making processes of the company. There is no universally accepted mathematical formula based upon shareholding or votes alone.[84] The 4$^{th}$ edited OECD Draft MIA for example provides that a certain investor or group of investors in concert should hold more than fifty percent of the ordinary shares. In

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[82]Treaty between the Federal Republic of Germany and the Federal Democratic Republic of Ethiopia concerning the Encouragement and Reciprocal Protection of Investments (signed 19 Jan 2004), Article 1(3)(b)

[83] *Nikièma* , n, 29, 28

[84] Christoph Schreuer , 'Commentary on the ICSID Convention Articles 25 (cont), 26 and 27' (2011) 'Foreign Investment Law Journal',113, Cited in Nerets, n,63

addition they need to have the voting power in such company to say there is effective control.[85] Many treaties use the control test as one criterion together with other tests such as the incorporation and company seat criteria. This criterion is stronger in creating genuine economic link between the company and its home state. For this reason, the ownership/control test is highly relevant to prevent multiple claims by discrete members of corporate groups, and problem.[86] However, its very technical nature makes harder to establish the real owners and controllers in company. The frequent retransfer of company's shares between different sets of persons also makes the task reaching the actual nationality of the company entirely.

### 2.5. Grounds of *Treaty-Shopping*

*Treaty shopping* became so prevalent since the 1990s within international investment and gained momentous attention.[87] With the advent of international trade and investment, broad definitional terms employed in BITs are expanding protections to economic actors beyond the signatories' intent. Broad definition of 'investors' and 'investment' in treaties is the main factor behind the phenomenon. More particularly the exclusive use of the incorporation criterion in delimiting company nationality is fundamentally related to *treaty-shopping*. Some states have recently started to place limits on the opportunities for '*shell-companies'* from benefiting from their investment protections. Similarly the European Parliament endorsed a resolution which calls for a survey to investigate abusive MNCs practices attributed to broader definition of investors in BITs in European countries.[88] It also urged for the use of such assessments to clarify and reshuffle the legal definition of investors in investment treaties in order to bring about a much needed rebalancing of rights and obligations of investors.[89]

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[85]OECD,'Benchmark Definition of Foreign Investment' (Fourth Edition, 2008), <http://unctad.org/en/Docs/diaeia20102_en.pdf> accessed 20 May 2017.

[86]UNCTAD (2011) n, 69, 84

[87] Skinner M. et.al. (2010) n,31, 283

[88]Roos van Os & Roeline Knottnerus, 'Dutch Bilateral Investment Treaties: A gateway to 'treaty shopping' for investment protection by multinational companies, 2011) 5 <https://www.somo.nl/dutch-bilateral-investment-treaties-a-gateway-to-treaty-shopping-by-multinational-corporations-for-investment-protection/> accessed 12 June 2017

[89]Ibid

The Netherlands BITs are is typically known on matters concerning *treaty–shopping*. This could be proven by looking at the publicly available list of cases in international investment arbitrations. The fact that several cases involve Dutch *shell-companies* is because of the suitability of Netherlands' BITS to structure investment owing to their unrestrictive definition of investors. As of 2011, the country has been involved in ten percent of all four hundred known ICSID cases while it never took part in such litigations as a respondent[90]. The country is a popular base camp for (intermediate) holding and financial companies. More than twenty thousand *mail-box* companies, having no substantial investment undertakings have been registered in the country.[91] In addition to attractive tax climate, the Dutch foreign investment policy and extensive investment treaty protections played significant roles in attracting *shell-companies*. The Netherlands has one of the most pro-investor BITs that protect investments in other contracting states. It has currently more than ninety BITs many of which are still in force.

### 2.6. Types of ***Treaty-Shopping***

There are three major types, with almost the same purpose of *treaty-shopping*. In the next couple of paragraphs, each modality of *treaty-shopping* will be briefly explained. Let's assume that 'A', 'B' and 'C' are there states and 'A' and 'B' have signed a BIT while 'C' does not have any agreement with either. In the first mode, an investor, a national of 'C', benefits from the BIT between 'A', the target host state, and 'B'. This could be achieved through structuring investments in the aim of getting the nationality of state 'A'.

To demonstrate the second, let's change the scenario. Assuming that 'A' has signed different BITs with 'B' and 'C'. Nevertheless, an investor from 'C' gets some clauses of the BIT between 'A' and 'B' better protective than the BIT between 'A' and its home state. With the objective of benefiting from such former in the territory of 'B', the investor manages to get the nationality of 'A'.

In the third case, let's eliminate 'C' and assume that 'A' and 'B' have signed a BIT for reciprocal promotion and protection of investments. In such case, there is no ground to treat domestic

[90]John Lee, 'Resolving Concerns of Treaty Shopping in International Investment Arbitration' [2015] 'Journal of International Dispute Settlement' 355, 363 citing Van Os and Knottnerus, n, 88
[91] The researcher uses Multinational Companies (MNCs), Transnational Companies (TNCs) and Multinational Enterprises (MNEs) interchangeably to denote legal entities that operate their investment activities in more than one state for the purpose of this work.

investors by each state as foreigner since there is no foreign element. In order for bypassing such limitations, ‘A’ nationals or companies will structure their investment to get the nationality of ‘B’. Afterwards, they start to claim benefit provided in the BIT.

### 2.7. Methods of *Treaty-Shopping*

Investors structure their investments for the purpose of getting the best protecting BIT between the host state and another. And this could be done either before or after the materialization of a claim. Channeling investments can be effected in two major ways: establishing ‘shell-companies’ or selling transferring legitimate claims.

In the first case, the investor suspects the occurrence of dispute with the target host state. Prior to the investment or in the course there of, it selects the best BIT between such state and others so that it could channel its investment to get the nationality of the latter. Similarly, an investor may make the same arrangements after it has entered in to a dispute with the host state. After investing its resources, and once the dispute has ensued, the investor then pursues the nationality crucial to benefit from a BIT which best protects its interests. International investment arbitration clause are primarily hunted by investors to meet such objectives.

Let’s consider an investment treaty concluded between two states, ‘A’ and ‘B’. Assuming that Company ‘X’ having the nationality of ‘B’ and having investments therein wants to exploit the BIT. Yet, it does not possess the nationality of ‘A’, important nationality to for such purpose. Then the ‘X’ establishes a *shell-company* or *mail-box* company, let’s refer it as ‘Y’. It’s important to bear in mind that the shares and management of the latter would be dominantly held by ‘X’. Subsequently, ‘X’ will channel its investments in to state ‘B’ through ‘X’.

To demonstrate the second method, let’s again consider the BIT between states ‘A’ and ‘B’. Again let’s assume Company ‘X’ having the nationality of ‘B’ and having investments therein. ‘X’ wants to exploit the BIT, yet it does not possess the nationality of ‘A’. Then, it will sell its claims to an already exiting company ‘Y’ in sate ‘A’. Then it’s the latter that stands against ‘B’. This option is generally used where a dispute is pending with the host state and the initial investor believes that it has no BIT protection. Normally, what company ‘X’ did is just selling its legitimate claim to another investor with a greater chance of succeeding against the respondent

through nationality. This method is referred to as *'trafficking in BITs claim'*[92].The *Phoenix Action* case best explains this method of BITs shopping, which will be demonstrated later in this chapter.

## 2.8. The Controversy over Treaty-Shopping

### 2.8.1. The Debates about Legality of *Treaty-Shopping*

There is no consensus regarding the desirability as well as the legitimacy of *treaty-shopping*. Deep controversy is prevailing as to the legitimacy as well as desirability of the practice. Scholars and international arbitration tribunals hold divergent positions regarding this point. They associate the subject matter vis-à-vis three parties in international investment law, the investor, the capital importing host state and the capital exporting home estate.

The first group contends that, *treaty-shopping* is like one business planning in respect of the investor. They argue that the investors channel their investments after looking in to BITs advantages of contracting target hosts states. As far as doing so is not explicitly prohibited in investment treaties, there is no way to condemn the practice. They also state, the ultimate objective of any state in signing investment treaties is fundamentally creating investor friendly atmosphere in its territory. Thus they argue, the origin of the capitals is of no significance to the capital importer state. This line of reasoning makes the practice legitimate and acceptable business exercise in respect of investors. For this reason, they assert, *treaty-shopping* presents no observable threat to the capital importing state. Capital exporting countries and the investor on one hand are always presumed to be beneficiary of such practice. This is because, investment treaties normally are platforms between the host state and the investor. They impose lesser obligations on the part of the other contracting state and the investor. It's also worth of noticing that the practice is purposely carried out by the investor after making a learnt cost benefit analysis.

The second group propagates the opposite position. They say, investment treaties in general and *treaty-shopping* in particular present serious jeopardies to the capital importing state. What *treaty -shopping* actually does is that, they argue, it increases the risks of such state through claims which it never anticipates. It exposes such state to get in to trouble with parties which it might

[92]Skinner et.al, n, 31, footnote *13*

not be willing to protect had all circumstances were known to it in the first place. It disrupts the regulatory space of governments hosting foreign investments.

Some developing countries have expressed their disappointment, and consequently threatened to abandon their BITs and withdraw from the ICSID Convention. Bolivia, Ecuador and Venezuela so far have left the ICSID because of grievances in relation to cases decided to their prejudice.[93] These states alleged the exact cause for them to denounce the ICSID is intercepted BITs and the incapability of ICSID to tackle the phenomenon.

### 2.8.2. Prominent International Arbitral Cases involving *Treaty-Shopping*

Tribunals' perception of *treaty-shopping* profoundly varies from case to case. As said earlier, Netherland's BITs have been exceptionally known for their suitability of structuring investments that they are behind many allegations of *shopping*.[94] The broad definitions (incorporation criterion) of 'investor' in Dutch BITs created considerable avenues for expansive interpretation of BITs by international investment arbitrations. Out of the total forty arbitration decisions involving as of 2011,[95] twenty nine claimants were known to have been registered in the Netherlands. Twenty five were merely *mail-box* companies which do not have any permanent employee or economic activity in the Netherlands. Venezuela and Czech Republic are states which are hard hit by companies covered under Dutch BITs. Venezuela was eight times sued by such companies where as Czech Republic was brought in to ISCID six times. In subsequent paragraphs, brief discussion is made on selected and well-known cases in law of international investment concerning *treaty-shopping*.

***Lauder v Czech Republic***

This case involves one of the often talked controversy regarding the essence of *treaty-shopping* international investment law. A US investor, Mr. Ron Lauder initiated two arbitrations in the

[93] Bolivia denounced the ICSID in 2007, Ecuador did the same in 2009 and Venezuela left in 2012.

[94] Annika Stormy, Mildner S et.al., 'International Investment Agreements and Investor State Dispute Settlement: Fears, Facts, Faultlines, 'Background Paper, *Federation of German Industries Department for External Economic Policy* ' 2015) 15, <http://bdi.eu/BDI_english/TTIP_investment_protection.htm> last accessed 12 June 2017

[95] Van and Knottnerus , n,88 29

UNCITRAL, one *Lauder v Czech Republic* using the US-Czech Republic BIT. The second was through his Dutch company CME in which he owns ninety nine percent of the shares *(CME v Czech Republic)* using the Czech-Netherland BIT. He lost the first case but won the second. In both proceedings, the respondent contested jurisdiction stating that Mr. Lauder's attempt to seek the same relief from two separate tribunals was improper and an abuse of the process. Both tribunals rejected those jurisdictional arguments. Here is what the tribunal reasoned out in rejecting Czech's objection in the CME tribunal.

> "The argument of abusive *treaty-shopping* is not convincing. A party may seek its legal protection under any scheme provided by the laws of the host country. The Netherlands treaty as well as the US treaty, is part of the laws of the Czech Republic and neither of the treaties supersedes the other. Any overlapping of the results of parallel process must be dealt with on the level of loss and quantum but not on the level of breach of treaty."[96]

The UNCITRAL ruling on the CME case has been caused by the over-wide definition of 'investor' in the Netherland-Czech BIT. It shows how different entities (owner, shareholder, investor) using the ownership chain of the multinational company are considered as independent or distinct nationals, each having its respective claim under the BITs available to it. It's also worth of noticing that the problem is caused by the incorporation test as the exclusive test of corporate nationality.

The procedural aspect of these cases illustrates how international investment law is currently interpreted and applied differently. The same measure by a single respondent state toward a single investor was interpreted divergently. In this case, it was shown how such discrepancy may render such state to face concurrent defense in a number of forums.[97] And this is a burden that

[96] *CME,* Paragraph 419

[97] *Nathalie Bernasconi Osterwalder* and Lise Johnson, *Key cases from 2000–2010, International Investment Law and Sustainable Development*, ( edn, International Institute for Sustainable Development) 36

could be especially difficult and yet one that exposes host states to excessive coasts[98], as well as confusion between contradicting awards in the end.

***Aguas del Tunari SA* v *Republic of Bolivia***

This case was arbitrated under the Netherlands–Bolivia BIT. Objecting to the jurisdiction of the ICSID, the respondent contended that *Aguas del Tunari* was not national of Netherland since it was not an entity which was controlled directly or indirectly by national of the Netherlands despite that was set forth under Article 1 (b) (ii) the BIT. Bolivia also held the opinion that 'effective control' pursuant to the BIT referred to ultimate ownership, which belonged to a US company, *Bechtel.* The tribunal however pointed out that it would not read an ambiguous clause as an implicit waiver of jurisdiction: silence as to the question is not sufficient.[99] It stated that it is neither uncommon nor illegal for investors to locate their operations in states which have tax benefits and less environmental regulations as well as better protective BITs in this respect.[100] The tribunal was sympathetic of the respondent's objection which was expressed as follows.

> "This decision reflects the growing web of treaty based referrals to arbitration of certain investment disputes. Although titled bilateral investment treaties, this case makes clear that which has been clear to negotiating states for some time, namely that through the definition of 'national' or 'investor' such treaties serve in many cases more broadly as portals through which investments are structured, organized, and, most importantly, encouraged through the availability of a neutral forum. The language of the definition of 'national' in many BITS evidences that such national routing of investments is entirely in keeping with the purpose of the instruments and the motivations of the state parties."[101]

***Saluka Investment BV* v. Czech Republic**

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[98] There are almost rare instances that investor-state arbitrations ruled to the effect that a respondent state should be reimbursed costs of arbitration even if it was wrongly subjected to the forum and it won the case in the end.

[99]*Aguas del Tunari, S.A. V. Republic of Bolivia*, (2005), Decision on Respondent's Objection to Jurisdiction, ICSID, Case No. ARB/02/3

[100]*Aguas del Tunari, S.A. v Bolivia*, (2004), Decision on Jurisdiction, ICSID, Case No. ARB/ 02/3, Paragraph 122

[101]*Aguas del Tunari S.A*. n, 99

A Japanese Bank called *Namura* created a special purpose vehicle called *Saluka* Investment BV in Netherlands. The latter angered by measures allegedly taken by the Czech government, brought a claim before the UNCITRAL in the year 2004 using the Czech Republic-Netherlands BIT. In challenging jurisdiction, Czech Republic contended that the actual owner of the investment was *Namura* and not the *Saluka BV*. The respondent also explained the claimant was merely '*shell-company*'[102] in furthering its argument that the claim should be dismissed since *Nomura* did not have any *bona fide* factual links with Netherlands. As such, according to the respondent, the claimant did not satisfy the requirements necessary to qualify as an 'investor' to benefit from the provisions of the treaty.

The tribunal criticized this argument putting that, the BIT contained no language which would exclude holding companies, *Saluka Investment BV* in that case, from benefiting by investment treaties. Though the case was decided in favor of the claimant, the tribunal was not in complete disregard of the respondent's arguments. Similar to *Aguas del Tunari SA,* it tried to be compassionate about the contention of the respondent which was stated as:

> "Such a possibility lends itself to abuses of the arbitral procedure, and to practices of *treaty-shopping* which can share many of the disadvantages of the widely criticized practice of forum shopping."[103]

However, the tribunal was tick to Czech-Netherland's BIT. In this regard, it stated that the predominant factor which must guide the tribunal's discharge of its responsibilities was the terms agreed by the BIT parties to establish the tribunal's jurisdiction. Accordingly, it stated, it was the claimant which can be the beneficiary of the BIT to initiate arbitration up on that. The parties had complete freedom of determining who could be claimant on the treaty and they chose to limit entitled 'investors' to those satisfying the definition set out in Article 1 of the treaty. The tribunal cannot in effect impose upon the parties, a definitions other than that which they themselves agreed on. That agreed definition required only that the claimant-investor should be constituted under the laws of, (in the present case) Netherlands, and it was not open to the tribunal to add

[102] *Saluka Investments B.V. v. The Czech Republic*, (2006), Partial Award, UNCITRAL, Par 199 (h).

[103] *Saluka* case, n, 99, par. 240

other requirements which the parties could themselves have added but which they omitted to add.

***Mobil v Venezuela***

Mobil Corporation and many of its affiliates (Mobil) invested in the exploration and production of oil in Venezuela since the 1990s. In 2004, Venezuela introduced levying a series of tax increases on private petroleum interests that also affected Mobil. During late 2005 and 2006, Mobil rearranged its corporate structure so that a holding company organized under the laws of the Netherlands, *Venezuela Holdings B.V*. In 2007 January, Venezuela issued a decree for nationalization of the sector including Mobil's petroleum investments.

The *Mobil v. Venezuela* arbitration was thus prompted by the respondent's nationalization measure which deprived the claimant's interests. There were also two other claimants, Delaware (US) holding companies, and two Bahamian companies with Venezuela Holding BV. The claimant initiated the arbitration invoking the 1993 Netherlands-Venezuela BIT.

Venezuela contested the BIT did not provide possibility for the ICSID jurisdiction over the dispute. Finally, the tribunal ruled that the Dutch holding Venezuela Holdings is a 'corporation of convenience' created in anticipation of litigation against the Republic of Venezuela for the sole purpose of gaining access to ICSID, and concluded that abuse of the corporate form and blatant *treaty-shopping* should not be condoned."[104]

In respect of the BIT provision, the respondent suggested that the obligation of the BIT party runs only to nationals of the other Contracting Party with respect to their own investments. It also added, such plat forms would only to the extent that those investment activities over which the dispute arouse were located in the territory of the respondent state.

Lastly ICSID put that the main if not the whole purpose of the restructuring was for getting access to ICSID arbitration through the Venezuela-Netherlands BIT. Based on that, the tribunal concluded, the investment restructuring against breaches of rights by the Venezuelan authorities was a perfectly legitimate motive as far as that was concerned with future disputes. However, it noted, the situation was different with regard to pre-existing disputes. It considered that to

[104] Skinner , n, 31

restructure investments only in order to gain jurisdiction under a BIT for such disputes would amount to an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs.[105]

***Phoenix Action* Ltd. *v Czech Republic***

*Phoenix Action Ltd* v *Czech Republic* (*Phoenix Action)* best explains prohibitive response to abusive *treaty-shopping* practices by investment arbitration tribunals. This claim arose following *Phoenix's* (Israeli incorporated company) acquisition of two metal Czech companies, *Benet Praha* and *Benet* Group. Those companies were controlled by a Czech national (*Vladimir Beno).* The companies were sold to *Phoenix* after they became involved in court proceedings before Czech courts for civil and criminal liabilities. *Benet* Group was alleged to have taken ownership of three other Czech companies one of which was insolvent. *Benet Praha* on the other hand was in criminal prosecution for tax fraud and custom duty evasions that resulted in the judicial freezing and seizure of its assets. Mr. *Beno* sold *Benet Praha* and *Benet* Group to *Phoenix* in the knowledge that the latter was incorporated in Israel by one of his family members. Two months following the acquisition of those companies, *Phoenix* put on Czech Republic on notice as to its intention for arbitration on account of actions taken by the latter against the two before the takeover took place.

On February 2004, just eleven months later, *Phoenix* initiated arbitration against the Czech Republic under the Israel–Czech Republic BIT. In its pleading, *Phoenix* alleged that the Czech courts failed to promptly resolve the actions involving *Praha* and *Benet* Group which tantamount to expropriation of *Phoenix'*s assets and a breach of the FET as well as and FPS in the BIT.[106]

At the hearing on jurisdiction, the respondent argued that the tribunal was not eligible to hear the case because of the nature of the claimant. It stated that *Phoenix* was nothing more than an ex-post facto fabrication of a sham Israeli entity created by a Czech fugitive from justice, *Vladimir Beno*, to create diversity of nationality.

[105] *Mobil Corporation, Venezuela Holdings B. v Republic of Venezuela*, (2010), Decision on Jurisdiction, ICSID Case No. ARB/07/27

[106] Agreement between the Government of the Czech Republic and the Government of the State of Israel on the Reciprocal Promotion and Protection of Investments (signed 23 September 1997

The respondent described the claim as 'one of the most egregious cases of *treaty-shopping* seen in history of investment arbitration. In relation to that, it stated that the tribunal's assumption of jurisdiction was grossly erroneous which would end up with a decision that would justify the creation of foreign entity solely for creating diversity of nationality for ICSID arbitration.[107] It also added, the acts which constituted violation of the BIT happened before *Phoenix* acquisition of Mr. *Beno*'s companies that strongly delegitimizes the tribunal's jurisdiction.

The tribunal upheld the principle of good faith in international trade and laid four basic criteria to be taken into account in examining whether the complainant was in *bona fide* intention to engage in economic activities in the host state. These were timing of the investment, timing of the claim, substance of the transaction and the true nature of the operation. In the first case, the tribunal stressed that *Phoenix*'s investment was burdened with civil and criminal litigations in relation to acts done by the parent companies. Secondly, it underpinned that the alleged acts of violation by the respondent were happened before the takeover took place which would justify that *Phoenix* was not the right party to make claims. Most interestingly, the tribunal emphasized on the fact that the complainant sent its notification for arbitration to the respondent before it was fully registered in Israel which would magnifys bad faith. Third, the tribunal stated that the transaction took place between family members without 'arm's length principle'. It stated that the shares of the two companies were substantially discounted to facilitate the creation of *Phoenix* in Israel. And lastly, it said, the claimant did not have any economic interests in the territory of the respondent state. *Phoenix* had economic objectives nor assets in Czech Republic. Based on such strong reasoning, the tribunal declined request of jurisdiction for the arbitration. It lastly put that the manifest purpose behind the sale of the two companies to the claimant was an attempt to internationalize purely domestic investment to get ICSID facility.

***TSA Spectrum de Argentina v Argentina S.A. (TSA) v Argentina Republic***

*TSA* was an Argentine subsidiary that took over a Netherland registered corporation, *TSI Spectrum International N.V.* The claimant, alleging that Argentina expropriated its investment, complained it breached FET and impaired the management and operation of its investment

[107] See *Phoenix Action, (20121), Decision on Jurisdiction, ICSID Case No. ARB/06/5*

interests and etc.[108] *TSA* initiated arbitration in the ICSID using the Argentina- Netherland BIT. The tribunal started to examine whether the claimant could make use of the BIT to file the suit in the ICSID. This was following respondent's objection on jurisdiction stating that *TSA* was owned by its own national and not protected by the Argentina-Netherland BIT from the very beginning.[109]

In coming to a decision, the tribunal struggled t to find the meaning of Article 25(2) (b) of the ICSID Convention which provides two categories of investors. The first are 'nationals of another Contracting State': those holding foreign citizenship, and the second, a domestically incorporated company under foreign control. *TSA* did not fall under the first category because it was Argentine company owned by an Argentine citizen. The second inquiry dissected the members of the tribunal in to two. This division also triggered fundamentally important issue in international investment law: whether piercing the corporate veil was compulsory or not. Two out of the three arbitrators sided in favor and one sided against piercing. The first stated, given the ICSID is intended to settle disputes between foreign investors and host states, that approach was particularly important 'when ultimate control' was alleged to be in the hands of nationals of the host State, whose formal nationality was also that of the Claimant corporation.

In his disagreeing opinion, one of the arbitrator, Grant D. *Aldonas*, stated that looking beyond where *TSA* was incorporated would lead the tribunal to what is not contemplated by the BIT parties and what is stipulated in the ICSID Convention. He added, to do that would also substitute the tribunal's judgment for that of the two sovereign states since the Argentina–Netherland BIT made clear that it protected companies lawfully incorporated in the Netherlands, irrespective of who owns them.

There were also additional issues raised by the respondent to contest jurisdiction though the issue of foreign control significantly influenced the outcome of the decision to support respondent's

[108] *TSA Spectrum de Argentina S.A. V Argentina Republic*, Decision on Jurisdiction (2008), ICSID, Case No. ARB/05/5, 2, 12, par 36

[109] *TSA Spectrum de Argentina S.A. V Argentina Republic*, Decision on Jurisdiction (2008), ICSID, Case No. ARB/05/5, P. 14, Par.39 (c)

arguments.[110] Generally, the above cases powerfully reflect how the rulings of ISDS centers is significantly unpredictable the outcome of which is exacerbated by the absence of appeal against absurd decisions in the arbitration system.[111] Whereas some managed for expansive interpretation of BITs terms, many others sided to clear meanings with strict adherence to BITs terms[112]. It's very unlikely for piercing the corporate veil over plain BIT provisions to look behind the company or to examine the existence of genuine link except for few cases. This includes in situations when corporate personality is misused as mask to defraud third parties or grave cases of malfeasance as indicated in the *Barcelona Traction* Case.[113]

The paradox on corporate nationality persists which necessitates the vitality of giving emphasis to the definition of investor. Normally there is no rule of precedent in international investment law. Consequently, a tribunal will not be bound to maintain previous rulings on similar cases. There are indeed instances that tribunals cite previous decisions though the outcome may be completely different to their references.

### 2.9. Damaging Effects of *Treaty-shopping*

The consequences of *BITs-shopping* evolve slowly but they are too sophisticated and have long lasting negative implications over the host state's investment climate. Many of these problems are undetectable before investor-state disputes ensue which might take some quarter years.[114] They can affect not only the investment treaty regime, but also critically disrupt the investor state arbitration system which is problematical.[115] The experience of Venezuela[116] is a noble evidence

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[110] *TSA Spectrum de Argentina S.A. V Argentina Republic*, Decision on Jurisdiction (2008), ICSID, Case No. ARB/05/5, P. 14, Par. 39 ( a, b, d)

[111] Marta L, and Puccio Laura, 'Investor State Dispute Settlement (ISDS) State of Play and prospects for Reform' (2015) 'EPRS' *http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI last visited 9 June 2017*

[112] Christoph Schreuer, 'Nationality of Investors: Legitimate Restrictions vs Business Interests' 'ICSID Review-Foreign Investment Law Journal' 525.

[113]Case Concerning Barcelona Traction, Light and Power Co.Ltd., (Belgium V Spain), (1970), ICJ, Rep.3 Par 56

[114] Paul Michael Blyschak, 'Access and Advantage Expanded: Mobil Corporation v Venezuela and other Recent Arbitration Awards on Treaty Shopping' (2011) cited in Lee, n,87, 357

[115]Ibid

[116] Argentina is known to have been sued by a lot number of Dutch and American companies in the ICSID following the 1998 economic crisis in the country. The crisis drew serious of government stabilization measures pushing these

to show this narrative that obliged the country to terminate its investment treaty with Netherlands in 2008.[117] Venezuela is also the third state to deplore the ICSID following Bolivia and Ecuador[118]. The country took these measures after shaken by series of suits in the ICSID filed by Dutch *shell-companies* which were actually controlled by American companies. Venezuela faced problems caused by *shopping* of its BITs by many Dutch nominal companies subjecting the country to number of ICSID arbitrations for decades. The same phenomena were caused to Argentina and Czech Republic. Australia also described agreeing for international investor-state arbitration as acting like a '*Trojan Horse'*, opening the floodgates for multinational companies to undermine state autonomy.[119]

*Treaty-shopping* is undesirable from the view point of sustainable development from various standpoints. The following paragraphs explain how the problem causes recurring obstacles on development endeavors of the host states.

**It erodes the principle of reciprocity**

The first and the furthermost accepted argument by opponents of *treaty-shopping* is that it erodes the principle of reciprocity and abuses the consent of state parties to BITs.[120] The common understanding behind any BIT is reciprocal commitment for treatments of investors/investments. This is even resonated in the very title of all BITs of Ethiopia. [121]

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companies to file arbitration proceedings. No sate so far has been subjected to the ICSID arbitration more than Argentina.

[117] Luke Eric Peterson , 'Venezuela Surprises the Netherlands with Termination Notice for BIT; Treaty has been Used by any Investors to 'Route' Investments into Venezuela' (IA Reporter, 16 May 2008) <https://www.iareporter.com/articles/venezuela-surprises-the-netherlands-with-termination-notice-for-bit-treaty-has-been-used-by-many-investors-to-route-investments-into-venezuela/> accessed 18 April 2017

[118]Sergey Ripinsky,'Venezuela's Withdrawal from ICSID: What it Does and Does Not Achieve' (IISD Investment Treaty News, 13 April 2012) http://www.iisd.org/itn/2012/04/13/venezuelas-withdrawalfrom-icsid-what-it-does-and-does-not-achieve/ accessed 17 May 2017

[119] Peter Wish Wilson, 'Greens Introduce Bill to Protect the Public Interest Against Trojan Horse Provisions in Trade Agreements'Greens MPs Blog, 05 March 2014*)* <http://peter-whish-wilson.greensmps.org.au/articles/greens-introduce-bill-protect-public-interest-against-trojan-horse-provisions-trade> accessed 5May 2017

[120] Lee, n, 90, 359

[121]See for instance Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Democratic Republic of Algeria on the Reciprocal Promotion and Protection of Investments (signed 4 June 2004)

Thus *treaty-shopping* jeopardizes this principle that a company in this very specific research, with no genuine links to a contracting state could avail itself of the BIT benefits. In such course of things, the home state of such company may not be willing to accord similar treatments to investors of the host state. This means *treaty-shopping* in international investment grants wind fall benefit to one state while posing risks to the other.[122] Shortly, companies without genuine ties to a certain state are 'free riders' or 'corporations of convenience.'[123]

Some scholars reject this line of argument proclaiming that the essence of reciprocity in BITs should not be understood like its classical concept in public international law. Instead they argue, the purpose of BITs is to attract foreign capital. Thus they extend, it is irrelevant for the host state to bother about the origin of such capital.[124] However , opponents criticize this saying that a state which signed a BIT generally surrenders some of its right of diplomatic sovereignty when it submits to international arbitrations by the unilateral motion of the investor. But, through *treaty-shopping* a MNC may still be able to claim the best protection in addition to having recourse under the relevant BIT.[125]

**Multiplicity of Legal Proceedings and Claims**

When treaties are *shopped*, they become heaven for different sets of claims by different parties. The potential threats arise particularly from the company itself and its shareholders. Though this could be somehow predicted from the side of the main company, shareholders claim is very sophisticated in situations when the company has different layers. Shareholders' right of taking a host state in to international arbitrations is the subject of debate. One has thus to bear in mind

[122]Van Os Knottnerus , n, 88, 11

[123] John Lee, 'Resolving Concerns of Treaty Shopping in International Investment Arbitration' (2015) 'Journal of International Dispute Settlement', citing Schreuer < <https://academic.oup.com/jids/article/6/2/355/820022/Resolving-Concerns-of-Treaty-Shopping-in> accessed 18 May 2017

[124]UNCTAD, 'Scope and Definition' 2011), '*UNCTAD Series on Issues in International Investment Agreements II'*, <http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20(IIA)/UNCTAD-Series-on-issues-on-international-investment-agreements.aspx>

[125]Joost Paulelyn, 'At the Edge of Chaos? Foreign Investment Law as a Complex Adaptive System, How it Emerged and How It Can Be Reformed' (2014) Vol. 29, No. 2 'ICSID Review'

how such claims become unmanageable when they arise from a company and shareholders that are unknown to the host state.

The ICJ passed a momentous decision concerning shareholders right to take independent actions against a host sate in respect of damages caused to their company in *the Barcelona Traction* case[126]. In this case, ICJ decided, it's only in few exceptional circumstances that shareholders could bring claims in respect of the company's affairs. These are when the rights of shareholders is directly affected, or the company ceases to exist, or the state in which the company is incorporated lacks capacity to take action.[127] In all other cases, it's only the company which can stand before international arbitrations for damages caused to it. However, the ICJ did not dismiss the fact that damages caused to the company could ultimately affect the interests of the shareholders indirectly. In cognizant of this, it stated that:

> "no doubt, the interests of the aggrieved are affected, but not their rights. Thus whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered the same wrong, it is only one entity whose rights have been infringed." [128]

Some of successive ICSID decisions nevertheless significantly departed from the ICJ ruling. Respondent states on their part mentioned the *Barcelona Traction* case in several international arbitral proceedings to defend themselves raising the separation between the rights of company from its shareholders. Nonetheless, because of the broad definition of investor and (investment (which oftentimes includes portfolios) in investment treaties, cases were decided in favor of the shareholders[129]. And no regards were made as to whether the claimants were majority or

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[126] *Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belgium v Spain),* 5 February 1970 (1970) I.C.J. Reports 3 at 35-36, 9 I.L.M. 227

[127] Ibid

[128] Barcelona Traction, n. 124, 35

[129] Christoph Schreuer , 'Shareholder Protection in International Investment Law, 2005) 'Transnational Dispute Management' <www.transnational-dispute-management.com> ; S. Alexandrov, 'The 'Baby Boom of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals -Shareholders as 'Investors' under Investment Treaties' (2005) 'The Journal of World Investment and Trade', cited in OECD *'Definition of Investor and Investment 2008)* 36, footnote 125

minority shareholders[130] and whether the ownership of shares were direct or indirect.[131] Cases such as *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentine Republic*[132], and *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v Argentine Republic*[133]were all decided that way.

Hence, investors' right to bring independent action against the host state in respect of damages suffered by their company is another area of uncertainty in international investment arbitrations. As a result, it is clear that a host state may face different law suits by the parent company, subsidiaries, and different sets of shareholders. And in each of these companies and shareholders, there would be wide range of claims. When a state is a party to many BITs the greater the risk will be of multiple claims from a single investment and a single dispute all of which may erupt simultaneously. Because of this, the state could have to stand in numerous legal proceedings at different tribunals, possibly at the same time, with all compensations and the costs.[134] Apart from that there would be a real risk of conflicting arbitral awards and legal decisions.[135]

**Brings Indirect Claims from Adversary State**

The other drastic effect of *treaty-shopping* is that it can expose the host state to claims by companies to which it would not otherwise allow to enter in to its territory. The state may have its own policy objectives not to receive investors of certain origins. This includes situations when the other is adversary or enemy. Thus *treaty-shopping* erodes this as it depletes BITs to be infiltrated by unwanted investors from any place using base camp. Though investment treaties are entered in to with the aim of pulling foreign investment, getting access to investment

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[130] *Compania de Aguas Aconquija, S.S. & Compagnie Générale des Eaux* v. *Argentine Republic* (the Vivendi case), Decision on Annulment (2006), ICSID, Case No. ARB/97/3; *Champion Trading Co. and Others* v. *Arab Republic of Egypt,(2003),Decision on Jurisdiction,* ICSID, Case No. ARB/02/9; *LG&E Energy Corp.* v. *Argentine Republic* (2004), Decision on Objections to Jurisdiction, ICSID, Case No. ARB/02/01

[131] See *AAPL* v. *Sri Lanka* (1990), Award, ICSID, Reports 246; *Lanco Int'l Inc.* v. *Argentina Republic* (2001), Preliminary Decision on Jurisdiction, ICSID, par.463; *CMS Gas Transmission Company* v. *The Republic of Argentina*, (2003), Decision on Objections to Jurisdiction, ICSID case No. ARB/01/8.

[132] ICSID, Case No. ARB/97/3.

[133] ICSID, Case No. ARB/02/1

[134]Fritz, n,39, 11

[135] *Nikièma (2012)* n, 29; see *CME v. Czech Republic and R. S. Lauder v. Czech Republic* cases.

protections by all investors, especially of those adversary states is not necessarily favorable to a host state in terms of welfare and security. Many cases show MNCs have channeled their investments through other states in order to access investment protection not available to local competitors in the target host state.[136]

**It Causes Internationalization of Domestic Capital**

Customarily, the principle of nondiscrimination was to treat foreign investors in not less favorable conditions than domestic counterparts. The current aspect of nondiscrimination has eventually changed that there are better protections availed to foreign investors but not to the domestic ones. These are, *inter alia,* international standard of protections from expropriations, high standard of compensation during expropriation and the access to neutral international arbitrations in times of dispute.[137] This is clear evidence of the change of pattern on the principle of nondiscrimination.[138] As result, domestic investors manage to establish '*shell-companies'* in other states which have best protective BIT and bring back such capital as foreign investment. In effect, a capital will be unfairly internationalized which brings serious sovereignty constraints up on the part of the host state.

**It Affects Regulatory Space of Host State**

UNCTAD established that the awards from ISDS bodies are erroneous, inconsistent or contradicting to enforce and full of divergent interpretations thwarting the jurisprudence of the system. For example, several tribunals characterized investors 'legitimate expectations' as a basic element of the FET standard. Sates' regulatory changes such as the adoption of new laws, tax reforms, improving public revenues, imposition of performance requirements, and efforts to address historical injustices, or protect the environment or public health were challenged by foreign investors. Decline in investor's returns triggered arbitrations as breaching of 'investor's legitimate expectation' by the host state to justify compensations.  Some decisions gave FET

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[136] See *Tokios Tokles*

[137] Subedi S, *International Investment Law: Reconciling Policy and Principle*, (2008)183

[138] Subedi  S 'The Notion of Free Trade and the First Ten Years of the World Trade Organization: How Level is the "Level Playing Field?' (2006) 'The Netherlands International Law Review' 273–96, cited in *Subedi, (*2008) n,135,183

standard as a state obligation to guarantee a stable and predictable business environment. The same interpretations have been given with respect to indirect expropriation. Because of the vagueness of these concepts, tribunals have abused the system of the arbitration in the cover of interpretation to favor investors.

International investment arbitrations are dominated by very few arbitrators and large profit driven law firms of developed states which have huge leverage with no or less transparency. These forums are also places where a single person may wear different hats in different times (as arbitrator, expert witness or subsequently investors' advocate) magnifying the possible conflict of interests. Arbitrators have expansive interpretative latitude enabling them to down play a wide range of state regulatory spaces which matter to public interest.[139] Since tribunals treat cases from the side of commercial law, they tend to compromise public welfare.

South Africa's experience in relation to the '*Black Empowerment Act'* best describes the challenges investment treaties bear on government to formulate investment policy objectives. The South African government enacted '*Blacks Empowerment Act'*[140] to redress historical injustice committed during the *apartheid* led regime against indigenous peoples of the country. Among several measures introduced through such act includes requiring the transfer of some economic power in to the hands of indigenous people, what some scholars referred to as positive discrimination.[141] For instances, changes to the mining laws were made entailing giving greater participation (twenty percent of shares) to black people who were disadvantaged during the *apartheid* rule.

This measure prompted one arbitration in the ICSID by *Piero Foresti, Laura de Carli, (*a Luxemburg registered company owned by group of Italian nationals) and others in 2007. The complainant alleged the new mining charter amounted to expropriation and a breach of FET of

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[139] Fritz,(2015) n, 39, 11

[140] Directive 2014/40/EU of The European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC <https://ec.europa.eu/health/sites/health/files/tobacco/docs/dir_201440_en.pdf>

[141] M Sornarajah ., *International Law of Foreign Investment Law,* (3rd edition, Oxford University Press, Oxford, 2010) 344

the South Africa-Belgian Luxemburg BIT.[142] In 2010, the parties agreed on a settlement significantly dropping the requirement to deprive shares to South Africans.

It's this case that lessoned the South African government to reconsider many of its past investment treaties. Over the next three years, South Africa critically reviewed its investment framework and the twenty IIAs in force. The Department of Trade and Industry decided in 2009 that: "BITs extend far into developing countries' policy space, imposing damaging binding investment rules with far-reaching consequences for sustainable development".[143]

In 2010, South Africa decided to stop to enter into new investment treaties unless compelling political or economic reasons demanded. Subsequently, government announced that it would terminate existing investment treaties with some state but offered the possibility to re-negotiate IIAs on the basis of a new model.[144] In 2012, South Africa terminated its investment treaty with Belgium and Luxemburg, the BIT which was invoked in the *Piero Foresti, Laura de Carli* case. In 2013, South Africa sent similar notices of termination to Spain, Germany, Switzerland and Netherlands.[145] In the same year, the South African government published a draft investment law, 'Promotion and Protection of Investment Bill.'[146]

The new bill excluded the FET as opposed to its predecessors. It also eliminated the old standard of compensation during expropriation in such a way that compensation should reflect an equitable balance between the public interest and the interests of those affected. Thus market value of compensation became no more for granted. And most notably, the new act provides no general right to refer investment disputes in to international arbitrations: all investment disputes are to be settled in domestic courts.

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[142] *Foresti vs South Africa*, (2010), ICSID, Case No. ARB (AF)/07/1, 4

[143] 'Republic of South Africa 2009: Bilateral Investment Treaty Policy Framework Review, Government Position Paper, Pretoria' (2009) cited Fritz (2015), n, 39, 20

[144] Xavier Carim, 'Lessons from South Africa's BITs review'(2011) 'Vale Columbia Center on Sustainable International Investment, Columbia FDI perspectives' cited in Fritz, n, 39

[145] See <http://www.bdlive.co.za/business/trade/2013/11/12/eu-steps-up-fight-to-have-treaties-with-sa-retained>, cited in Fritz , n,39, 21

[146]See Republic of South Africa 2013, Promotion and Protection of Investment Bill, Government Gazette, 1 November 2013, No. 36995, <https://www.greengazette.co.za/documents/national-gazette-36995-of-01-november-2013-vol-581_20131101-GGN-36995.pdf> last accessed 8 June 2017

To look in to other states measures, Australia assessed ISDS on a case-by-case basis. Australia recently agreed an investment treaty with the Pacific Islands which eliminated ISDS like that of South African practice. In March 2014, the Indonesian government refused to renew its BIT with Netherlands following a wider review of the relevance of such BIT to its development demands. Indonesia had been sued many times under various IIAs, each having compensation claims of hundreds of millions of dollars.

**It has Chilling Effect on Corporate Social Responsibilities**

*Treaty-shopping* presents danger on the integration of corporate social responsibility to international and domestic investment regimes. It is expected that future investment treaties would incorporate commitments on signatory states to address the issue of human rights and environmental issues.[147] The efforts of states to address such new developments might be defied by the use of *treaty haven*. Investors will escape from obligations to set human rights and environmental standards through setting up their companies in states that do have no such clauses though the BITs between the host state and the actual home state of the investors might have these standards. For instance, Article 28 (9) of the Investment Agreement for the COMESA Common Investment Area (CCIA) incorporates the issue of CRC as follows.

> "A Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defense, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement, including the obligations to comply with all applicable domestic measures or that it has not taken all reasonable steps to mitigate possible damages."[148]

This provision could be counterbalanced by route to a '*treaty haven'* agreement that pays no concern to CSR. The investor establishes a '*shell-company'* in other state which is not member to COMESA Common Investment Area Agreement and then structures its capital to any member.

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[147] The 2007 Norwegian Model BIT for example incorporates corporate social responsibility that allows the host state to keep oversight on the investor of the other contracting party in its territory to observe human rights and environmental restrictions based on the domestic legislations of the latter.

[148] Investment Agreement for the COMESA Common Investment Area (signed 2007), Art. 28 (9)

As a result, the latter may not raise the set off or counter claim provision as the nominal nationality of such company is not signatory to of this agreement. This sufficiently makes clear how *treaty-shopping* would undermine a clearly accepted international obligation by states. These factors paralyze states efforts to ensure sustainable development concerns.[149]

### 2.10. The Denial of Benefit Clause (DOB)

As investors try to build their legal structure in their favor, states may also seek in advance to prevent claims from some companies to which they did not intend to offer treaty protections. As a result, some treaties include a 'denial of benefit'. By denial of benefits clause, it's to refer to a clause in investment treaty that entitles the host state to deny the benefits to certain group of investors. Usually such exclusions apply to investors incorporated in one of the state party to the treaty but under control of investors of a non-contracting third state, or when the investor does not have substantial economic activities in the state of incorporation. Basically, this trend evolved after formal investor nationality was abused by persons which were not intended to be covered in BIT. DOB gives the host state the opportunity to effectively carve out from the definition of 'investor' '*shell-companies'* owned by nationals of a third-country or its own nationals.

DOB was acknowledged in the *Tokios Tokeles* and many other cases in the ICSID. The tribunal noted in *Tokios Tokeles* stated that, despite many investment agreements provide for DOB to entities controlled by the host state's own nationals, the Ukraine-Lithuania BIT did not do so.[150] The tribunal maintained that the clear treaty language should govern the parties in dispute unless fraud or abuse are discovered *bona fide* whereby veil would veil piercing to reach in to the real nationality of the corporation[151].

DOB is a recent development in investment treaties. For instance the ECT, the US BIT Model do have the DOB.[152] The 2008 US-Rwanda BIT provides that:

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[149]Peter Muchlinski, 'Corporations and the Uses of Law: International Investment Arbitration as a "Multilateral Legal Order"' (2011) Vol.no.4 'Oñati Socio-Legal Series' 22

[150] Toios Tokeles v *Ukraine, (*April 2004) Decision on Jurisdiction, ICSID, Case No. ARB/02/18, 15 par 36
[151]Ibid par 54

[152]Muchlinski, n,149,22

> "1. A Party may deny the benefits of this Treaty to an investor of the other Party that is an 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.[153]

There are also other investment agreements which include DOB such as investment treaties entered by China,[154] Canada[155], Austria[156] the Energy Charter Treaty (ECT)[157] and the ASEAN Comprehensive Agreement on Investment.[158] One can easily see the similarity among the contents of the clause in these treaties. The basis for the denial is made on the nationality of controllers or whether the investor has substantial economic undertakings in the home state. DOB as it appears in currently drafted investment treaties does not establish an out-and-out denial.[159] It's up to the host state to opt either way: it can offer or deny treaty benefits to

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[153]Treaty between the Government of The United States of America and the Government of the Republic of Rwanda Concerning the Encouragement and Reciprocal Protection of Investment (2008),Art.17 <https://ustr.gov/sites/default/files/uploads/agreements/bit/asset_upload_file743_14523.pdf>

[154] Agreement on Investment of the Framework Agreement on Comprehensive Economic Cooperation between the Association of Southeast Asian Nations and the People's Republic of China ( signed 2009), Art 15

[155] Agreement between the Government of Canada and the Government of the Republic of Costa Rica for the Protection and Promotion of Investments (signed 18 March 1998)

[156] Austria-Lebanon BIT, entered into force on 20 September 2002.

[157] ECT, Art.17

[158] ASEAN Comprehensive Investment Agreement, Art. 19

[159]Nikièma, 'Best Practices: Definition of Investor' (2012) 'The International Institute for Sustainable Development' 13, available at <http://www.iisd.org/pdf/2012/best_practices_definition_of_investor.pdf> last accessed June 12 2017

specified investors. One sees the abovementioned BITs and MIAs to look the permissive nature of the DOB clause. Some commentators say DOB should not be worded in such way to tackle the real threat of *shopping*.[160] Early arbitral tribunal practices have demonstrated that a discretionary DOB may be not as effective in practice as generally believed.[161] This is why the clause is termed 'not automatic' or subjective. This flexibility may seem to be an advantage for states. However, it has important legal implications before arbitration tribunals which have had to interpret it owing to its unpredictability.

DOB is a better solution to combat the issue of *treaty-shopping* especially in those BITs having unrestrictive nationality approach. However, this technique has practical difficulties which renders it ineffective as short term solutions. This is largely because most of the investment treaties have immunity system: those stringent restrictions on unilateral changes to the treaty commitments. The vast majority of BITs bind signatory states for a minimum of ten-fifteen years which is barrier to abdicate the impacts of bad definitions there in through DOB. Accordingly, unilateral withdrawal is not allowed before the expiry of such period unless mutual agreement is reached which is rare in most cases.[162] Besides, the issue of prohibition to unilaterally withdraw from BIT obligations is compounded by the so called 'tacit renewal', whereby the effect of the treaty is extended for another ten or fifteen years provided that at least one party fails to notify the other of its intention to terminate the treaty. Lastly, the effects of a treaty may be continuing even after it has been terminated with respect to those investments commenced prior to termination of the treaty. All these factors combined may significantly weaken the DOB. Be this as it may, the DOB clause is a better solution at least to reduce very predictable and egregious cases of the problem in investment treaties.

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[160]Sornarajah , n, 141, M, *The International Law on Foreign Investment*, (3rd edition, Oxford University Press, Oxford, 2010) 29

[161] UNCTAD (2011),n, 69,94

[162]UNCTAD 'Bilateral Investment Treaties 1995-2006:Trends in Investment Rulemaking'(2006) UNCTAD/ITE/IIT/2006/5

## CHAPTER THREE

## ISSUES OF *TREATY-SHOPPPING* UNDER ETHIOPIA'S BILATERAL INVESTMENT TREATIES

### 3.1. General Overview of Ethiopia's Bilateral Investment Treaties

Ethiopia is among one of few countries which is registering the fastest economic growth in the world. The country has larger market size, strategic geopolitical location which enables investments in the country to reach in to East Africa, North Africa and the Middle East.[163] Because of these and other factors, the country's attraction of foreign investment is increasing since the late 1990s. China, India, Sudan, Germany, Italy, Turkey, Saudi Arabia, the United Kingdom Canada and US are the major capital exporting states to the country since 1992.[164] The country is also receiving increasing FDI from Middle East states such as Israel, Yemen and Qatar recently in various investment sectors[165].

To fuel its increasing FDI ambitions, Ethiopia has signed many bilateral investment agreements, more than thirty by now.[166] The country's momentum of negotiating investment treaties is also rapidly growing when compared to the developed states. For instance, the US which started to sign treaties of Friendship Commerce and Navigation (FCNs) as early as in the eighteenth century did not have as many treaties as Ethiopia does have in the early phase of these agreements.[167] The US FCNs treaties were primarily aimed at creating smooth trade bases and were not purely investment centered. Ethiopia concluded bilateral investment promotion and protection agreements with Algeria, Austria, China, Denmark, Egypt, Germany, Finland, France, Iran, Israel, Italy, Kuwait, Libya, Malaysia, the Netherlands, Kingdom of Belgium and

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[163]Hailu Burayu, 'Settlement of Investment Disputes and the ICSID Convention: An Ethiopian Experience?' ( Masters Thesis, Addis Ababa University Law Faculty 2009) 125

[164]An Investment Guide to Ethiopia (2014) 7, available at http://www.investethiopia.gov.et/images/pdf/Investment_Guide_2014.pdf, accessed on March 31 2017.

[165] Martha Belete and Tilahun Esmael, 'Rethinking Ethiopia's Bilateral Investment Treaties in light of Recent Development in International Investment Arbitrations' (2014) Vol. 8 no.1 'Mizan Law Review'122

[166]An Investment Guide to Ethiopia , n,164,35

[167] Aaron Chandler, 'BITs, 'MFN Treatment and the PRC: The Impact of China's Ever-Evolving Bilateral Investment Treaty Practice' (2009) Vol.43 no.3 'American Bar Association' 1301-1310 <http://www.jstor.org/stable/40708207> accessed: 31 March2017

Luxemburg Russia, Sudan, Sweden, Switzerland, Tunisia, Turkey and Yemen.[168] The country has also other bilateral investment agreements which have not entered in to force signed with, Republic of Equatorial Guinea[169], India[170], Nigeria, South Africa[171], Spain[172] and United Kingdom.[173] Ethiopia also signed a protection of investment and property acquisition agreement with Djibouti.[174]Currently, Ethiopia has eight BITs with African states and twenty three BITs with states from other continents.[175]

### 3.2. The Structure of Ethiopia's BITs

The structure of all BITs reveals a striking similarity. Ethiopia's BITs all in all contain preamble paragraphs in their first sections. In these pieces of the agreements, the contracting states, *inter alia,* vividly show purpose of the agreements whereby they set forth their commitments of reciprocal encouragement and protection of investment in each other's territory. These determinations show the contracting parties' believes that doing so enhances their mutual investment desires and economic prosperity.[176] Except for minor changes of terminologies, all of the BITs of Ethiopia exhibit similar purposes.[177]

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[168]Ethiopia-Bilateral Investment Agreements, last published*7/9/2016* <https://www.export.gov/article?id=Ethiopia-Bilateral-Investment-Agreements>, accessed 21 April 21, 2017

[169] Signed 11 June 2009 at Malabo, ratified by Ethiopia on 14 January 2010, not ratified by Republic of Equatorial Guinea.
[170] Signed on 5 June 2005, ratified by Ethiopia on 11 August 2008, yet not ratified by Republic of India
[171] Signed on 18 March 2008 at Pretoria, ratified by Ethiopia on 10 July 2009, yet not ratified by South Africa
[172] Signed on 17 March 2009 at Madrid, ratified by Ethiopia 10 July 2009, yet not ratified by the Kingdom of Spain
[173] Signed on 19 November 2009 at Addis Ababa
[174] Preferential Investment Facilitation and Property Acquisition Agreement, signed on 18 November 2006, ratified by Ethiopia on 19 February 2007
[175] Investment Policies and Bilateral Investment Treaties in Africa: Implications for Regional Integration, United Nations Economic Commission for Africa, 2016,18, <http://www.uneca.org/sites/default/files/PublicationFiles/eng_investment_landscaping_study.pdf> last accessed 15 June 1017

[176]Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Federal Democratic Republic of Ethiopia for the Promotion and Protection of Investments ( signed 19 Jan 2009), Preamble, Paragraphs II, I

[177]Agreement between the Republic of Turkey and the Federal Republic of Ethiopia Concerning the Reciprocal Promotion and Protection of Investments ( signed 16 Nov 2000), Preamble, Paragraphs two and three; Agreement between The Government of The Federal Democratic Republic of Ethiopia and the Government of the Russian Federation on the Promotion and Reciprocal Protection of Investments (signed 10 Dec 2000), Preamble, Paragraph three

The second sections of the BITS contain definitional provisions which, among other things, sort out the types of investments and investors protected. Similar to other states practices, such sections of the treaties reveal very broad and illustrative lists of properties that would be owned by natural or legal persons of one party in the territory of the other.[178]

The third sections of the treaties the standard of treatment of the investor or the investment, or both. These sections of the agreements have both substantive and procedural rights. These include obligations on the part of the host state to guarantee international standards of expropriation, prohibition of adopting measures that prevent repatriation and prohibition to discriminate the investor against other investors of third states or the host state. They also encompass FET, full protection and security (FPS) of the investments by the host state.

### 3.3. Definition of Investor in Ethiopia's BITs

Generally, Article one of all the BITs define basic concepts in the BITs.[179] These terms include investment, investor, returns, territory etc. Excepting some variations like in terms of order, all the BITs contain such preliminaries to delineate what these terms stand for. Such definitional clauses play significant roles in holding investor state arbitrators from arbitrary and expansive interpretations of BIT terms. The country's BITs recognize two kinds of investors, natural persons and legal entities.

#### 3.3.1. Definition of Natural Persons

In all the BITs, natural persons are defined before legal persons. Natural persons are the citizens of the two contracting states the status of whom will be determined by the domestic laws of each party. If we look at the BIT between Ethiopia and Turkey for example, natural persons are meant to be the national of either contracting party in accordance with the applicable laws.[180] The BITs

[178] Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investments (signed 11 May 1998), Art. 1(1) and (2); Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the State of Israel for Reciprocal Promotion and Protection of Investments (signed 26 Nov 2003), Art.1(1) and (5)

[179] For exemplifying purpose, see the Ethio-Turkish BIT n, 177, Art. 1; the Ethio-Chinese BIT, n, 175, Art.1 ; Ethio-UK BIT, n, 176, Art.1

[180]Ethio-Turkish BIT, n,177, Art.1 (1) (a)

between Ethiopia and Malaysia, and Ethiopia and Israel however reveal some differences. These treaties recognize a permanent resident of either state as investor.[181]

One might argue that defining natural persons as investors plays minimal role as most foreign investment activities are carried out by companies. Nevertheless, apart from the possibility that natural persons may engage in huge investment activities overseas, doing so will contribute a lot for defining legal entities as well. This could be roughly viewed from some of Ethiopia's BITs that the definition of legal entities is made in reference to natural persons who form those firms. For example, this mode of defining companies is made in the BIT between Ethiopia and Sudanese BIT.[182] The Ethio-Sweden BIT also shares similar style of defining legal entities although the two treaties are not identical in all other aspects.[183] Hence, defining natural persons in BITs is convenient to delimit the holders of those legal entities in such BIT apart from its contribution to the significance for coherent legislative drafting.

### 3.3.2. Definition of Legal Entities

Definition of legal person is one of the most important things in investment treaties. For one reason, there are different types of legal persons to be recognized in investment treaties. These are state, companies, partnerships and association. Secondly, it's hardly possible to track these entities as opposed to natural persons that signifies the specification of their scope in BITs.

The BITs signed by Ethiopia also recognize different kinds of legal persons. Some of the BITs employ very general definitional phrases to include all kind legal persons. The Ethio-Chinese BIT could be an example here. It uses the phrase 'economic entities' to stand for all economic

[181]Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of Malaysia for the Promotion and Protection of Investments (signed 22 1998), Art. 1 (B) (I); Ethio-Israeli BIT, n,178 Art.1 (5) (2)

[182]Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the Republic of the Sudan on the Reciprocal Promotion and Protection of Investment (signed 7 March 2000), Art.1 (b) (ii) & (iii)

[183]Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of Sweden on the Reciprocal Promotion and Protection of Investment (signed 10 Dec 2004), Art. 1 (2) (c)

undertakings.[184] Some others illustrate those legal persons recognized in the treaties.[185] Few BITs make exhaustive list of those legal entities as investors.[186] The Ethio-Turkish BIT for example stipulates "corporations, firms or business associations incorporated or constituted under the law of either of the Parties and having their headquarters in the territory of that Party".[187] Besides, some of the BITs put state as an investor while others make no distinction between those entities having legal personality and those which do not have such status in the home states' law.[188]

Some of the BITs give no regard to whether the legal entities recognized in the BITs are profit driven or not. And finally, some BITs manage to use 'company'[189] to represent all types of legal entities with no distinctions as to personality and purpose. Some use 'enterprise'[190] instead of 'company' or 'legal entities' for the same meaning. Except for literal differences the BITs signify similar concept that is legal entities of all kind.[191] Some are too general without any list,[192] while others make some illustrations.[193]

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[184]Ethio-Chinese BIT, n,178, Art.1 (2) (b); Agreement on Reciprocal Promotion and Protection of Investments between the Government of the Federal Republic of Ethiopia and the Government of the Islamic Republic of Iran (signed in 21 Oct 2003), Art. 1(2) (b)

[185] Agreement between the Government of India and the Government of the Federal Republic of Ethiopia for the Reciprocal Promotion and Protection of Investments (signed 5 June 2005), Art. 1(2). The *Ethio-Danish* and the Ethio-Egyptian BITs follow similar definition with that of *Ethio-Indian* counterpart. See Agreement for the Promotion and Protection of Investments between the Arab Republic of Egypt and the Federal Democratic Republic of Ethiopia (signed 27 July 2006), Art. 1(3) (b)

[186]Ethio-Turkish BIT, n,177, Art.1 (1) (b)

[187]Ibid

[188] Treaty between the Federal Republic of Germany and the Federal Democratic Republic of Ethiopia Concerning the Encouragement and Reciprocal Protection of Investments (signed in19 Jan 2004), Art. (1)(3)(b)

[189] Agreement between the Government of the Federal Republic of Ethiopia and the Government of France for the Reciprocal Promotion and Protection of Investment of Investments (signed 25 June 2003), Art. 1 (3); See also, Agreement between the Federal Democratic Republic of Ethiopia and the Kingdom of Spain on the Promotion and Reciprocal Protection of Investments (signed 17 March 2009), Art. 1(2) (b)

[190]Agreement between the Republic of Austria and the Federal Democratic Republic of Ethiopia for the Promotion and Protection of Investments (signed 12 Nov 2004), Art. (1)(1)(b)

[191] Ethio-Germany BIT, n, 188, Art. 1(3) (b)

[192] See Agreement on encouragement and reciprocal protection of investments between the Federal Democratic Republic of Ethiopia and the Kingdom of the Netherlands (signed 16 May 2003), Art. 1 (a) (b) (ii)

[193]Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Great Socialist People's Libyan Arab Jamahiriya Concerning the Encouragement and Reciprocal Protection of Investments (signed 25 June 2004), Art.1 (2) (b)

On the other hand, the BIT between Ethiopia and Kuwait recognizes government of each state as investor,[194] whereas the BIT signed with Egypt does the same with respect to public enterprises.[195]

### 3.4. Nationality of Legal Entities

So far, a brief discussion has been made on how BITs signed by Ethiopia define 'investor' in general and, 'natural persons' and 'juridical persons' in particular. The next section of the work is keen to discuss how the nationality of legal entities is made in the Ethiopia's BITs. To begin with, Ethiopia has no BIT Model like the case of US[196] and Canada. When a country has a uniform Model BIT, the contents of BITs do not significantly change except for minor contextualization take place. The absence of such technique of treaty writing in Ethiopia could be easily inferred from the noticeable inconsistency of the country's BITS. If the nationality of legal entities in the country's BITs for example is mentioned, the basis of nationality greatly differs though few share similarity.

#### 3.4.1. Basis of Corporate Nationality

Ethiopia's BIITs define companies in relation to their nationality which is to be tracked using those tests previously discussed in chapter two. The BITs largely use the incorporation test and the company seat test. Some give cognizance to the place where the company operates business while much few give some focus for the extent of the economic activity in the territory where the business is driven. Hereunder, study is made how these tests scattered employed within the definitional provisions of the BITs of the country.

The incorporation criterion takes the highest place in Ethiopia's BITs used to define the nationality of companies. Out of twenty seven of the BITs visited for the purpose of this work,

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[194]Agreement between the Government of the Federal Democratic Republic of Ethiopia and the State of Kuwait Concerning the Encouragement and Reciprocal Protection of Investments (signed 14 Sep 1998), Art.1 (2) (b)

[195]Ethio-Egyptian BIT, n, 188, Art. 1 (2) (b)

[196] US has several times amended its Model BIT; the last being done in 2012 entitled as '2012 U.S. Model Bilateral Investment Treaty between the Government of The United States of America and the Government of [Country] Concerning the Encouragement and Reciprocal Protection of Investment.'

twenty six apply this test. The BITs exhibit differences in the terms used[197] and in the application of the criterion.[198] Most (twenty three) use the laws of the state in accordance of which the company is constituted or duly organized. On the other hand, the Ethio-Francis as well as Ethio-Algerian BITs use the cumulative of the laws and territory of the company's home state.[199] The BITs signed with Austria, Netherlands, UK and Tunisia use the incorporation criterion to define company nationality.[200] In other cases, the incorporation test is supplemented by other tests, such as requirements by the company to have seat or undertaking of economic activities in the home state for claiming nationality.

This company seat test is more often used following the incorporation test. Like in the former scenarios, the BITs use different base and terms in the construction of company seat. This includes head office[201], headquarters,[202] registered office[203] and sometimes domicile.[204] Others haphazardly employ words such as seat[205], principal place of business[206], central or practical place of administration etc. to denote company seat.

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[197] Provisions are articulated using the terms such as 'constituted, duly organized, or incorporated' interchangeably to denote company establishment based on the laws of the home state within or out of the territory of the state to which nationality is attached to.

[198] The treaties use incorporation on the basis of territory and/or laws in pursuance of which the company is established. They also use terms like constitution, incorporation, due organization alternatively.

[199] Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Democratic Republic of Algeria on the Reciprocal Promotion and Protection of Investments (2005), Art. 1 (2)(b); Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government the Republic of France on the Reciprocal Promotion and Protection of Investments (2004), Art 1(3)

[200] See Ethio-Austrian BIT, n, 190, Art.1 (b); Ethio-Netherlands BIT, n, 192, Art. 1 (c) (ii); Ethio-UK BIT, n, 176, Art. 1 (c) (ii)

[201] Agreement Between the Government of the Federal Democratic Republic of Ethiopia and the Government of the People's Democratic Republic of Algeria on the Reciprocal Promotion and Protection of Investments (signed 4 June 2004), Art. 1 (2)(b)

[202] Ethio-Turkish BIT, n, 177. Art. 1 (1) (b)

[203] Agreement between the Belgian Luxembourg Economic Union and the Federal Democratic Republic of Ethiopia on the Reciprocal Promotion and Protection of Investments (signed 26 Oct 2006), Art. 1(1) (b)

[204] Ethio-Chinese BIT, n, 178, Art.1 (2) (b)

[205] Agreement between the Government of the Republic of Equatorial Guinea and the Government of the Federal Democratic Republic of Ethiopia on the Reciprocal Promotion and Protection of Investments (signed 11 June 2009), Art. 1(2) (b)

[206] Agreement between the Government of the Republic of Finland and the Government of the Federal Democratic Republic of Ethiopia on the Promotion and Protection of Investments (signed 23 Feb 2006), Art. 1(3) (b

There is also a big difference regarding the degree of economic presence of the company where this is stipulated as criteria for company nationality. Some of the BITs make the association on the basis of economic undertaking activities in the territory of the home country with no specification as to the degree of such activities.[207] Few of the treaties give stress to the scale of such engagement. For instance, the BITs with Algeria[208], Denmark[209], Egypt[210], India[211], Libya[212], Russia[213] and Yemen[214] employ phrases "its economic activities" to reflect that the company should operate its overall economic activities within the territory of each of home state. On the other hand the BITs signed with Iran[215], South Africa[216] and Switzerland[217] employ phrases "effective or real economic activities". This obviously means, the fact that the company does have some economic operations overseas does not affect its nationality so long as the significant part of such undertaking is carried out in the home state. Delineating 'significant economic activities' however may not be as easy as it appears to be.

The ownership/control criterion is used the least in Ethiopia's BITs. In the first place, it has never been used to define the nationality of companies to be established in the territory of BIT parties in any of the treaties except the Ethio-Iranian BIT. Instead, it has been given some place with respect to companies established by the nationals or home based domestic companies which are located out of their territory. Accordingly, those BITs with France[218], Israel[219], Kuwait[220],

[207] See Ethio-Malaysian BIT, n, 181, Art. 1(1) (b) (ii); Ethio-Swedish BIT, n182, Art. (1) (2) (b)
[208] Ethio-Algerian BIT, n, 201, Article 1(2) (b)
[209], Agreement between the Federal Democratic Republic of Ethiopia and the Kingdom of Denmark Concerning the Promotion and Reciprocal Protection of Investments (signed 24 April 2001), Article 1(3) (b)

[210] Ethio-Egyptian BIT, n, 185, Art. 1 (2) (b)

[211] Ethio-Indian BIT, n, 185, Art. 1(2) (ii)
[212] Ethio-Libyan BIT, n, 193, Art. 1(2) (b)

[213] Ibid, Art. 1(1) (b)

[214], Agreement between the Government of the Federal Democratic Republic of Ethiopia and the Government of the Republic of Yemen on the Reciprocal Promotion and Protection of Investment (signed 15 April 1999), Art. 1(b) (ii)
[215]Ethio-Iranian BIT, n, 184, Art.1 (2)
[216]Agreement between the Government of The Republic of South Africa and the Government of the Federal Democratic Republic of Ethiopia for the Promotion and Reciprocal Protection of Investments (signed 17 April 2008), Art 1

[217]Agreement between the Swiss Federation and the Federal Democratic Republic of Ethiopia on the Reciprocal Protection off Investments (signed 26 June 19988), Art. 1 (1)(b)

[218]Ethio-Francis BIT, n, 189 Art. 1(3)
[219]Ethio-Israeli BIT, n, 178 Art. 1 (5) (b) (2)

Sweden[221], and Sudan[222] employ this test in some range of difference. It's only in the BIT between Ethiopia and Iran that ownership/control test is used as alternative to head office of the company with respect to companies located in the home state[223]. In the remaining BITs, the control/ownership test is applied to delimit companies that belong to nationals or companies of the contracting states which are located outside their jurisdiction.

### 3.5. Ethiopia's BITs vis-à-vis Exposure to *Treaty-Shopping*

Looking through Ethiopia's BITs, the researcher has perceived that there is inconsistency on company nationality. There is even no uniformity in using as single company nationality test. These criteria are dissimilar across the BITs on how they are based on and defined. There is also great deal of difference in using one company nationality criterion in relation to others. The incorporation test is most employed in the country's BITs compared to the two others. On the other hand the company seat test and the control criteria are usually used to supplement the first. The control test is used exclusively only in the *Ethio-Germany* BIT. Furthermore, the control test is neither used exclusively in any BIT, nor employed with respect to defining nationality of companies which operate in the territory of contracting parties. Besides some of the BITs put economic engagement in certain situations though this varies from BIT to BIT in respect of the extents of the economic presence.

The researcher found that many of Ethiopia's BITs are generally affected by the problem in varying degree. For systematic analysis of the BITs in relation to the phenomenon, it's convenient to categorize them in to three groups. Such classification is systematically done based on the intensity of the BITs exposure to the risk of *treaty-shopping*.

BITs would be labeled as highly exposed to *shopping* for two main reasons. First, it's when the nationality of investors, companies in this case, is constructed in unrestrictive approach. This is to mean when the BITs apply a single criterion of company nationality, especially, the incorporation test. The experience Latin American states such as Argentina, Bolivia, Czech

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[220]Ethio-Kuwait BIT, n, 194 Art. 1 (2) (b)
[221]Ethio-Swedish BIT, n, 208 Art. 1 (2) (c)
[222]Ethio-Sudanese BIT, n, 182 Art. 1 (b) (1) (ii)
[223]Ethio-Iranian BIT, n,184, Art.1 (2)

Republic, Ecuador and Venezuela is a good evidence to reach in to such conclusion. These states have been repeatedly sued by Dutch *shell-companies* one after the other. Secondly, the problem emanates frequently when BITs fail to insert the DOB. Based on these grounds, the BITs signed by Ethiopia with, Germany, Israel, Kuwait, Netherlands, Tunisia and the United Kingdom could be taken as highly exposed to the problem. All of these BITs employ a single criterion, the incorporation test to delineate company nationality. It's only the Ethio- Germany BIT which uses state of company seat. In addition, none of these treaties include the DOB to supplement the criteria.

On the other hand, those BITs signed with Austria, Belgium, Finland, France, Malaysia, Spain, Switzerland and Turkey can be put in to medium risk category. Though many of these BITs still significantly apply the incorporation criterion, they at least supplement it with the place of company seat. This minimizes the possibility of *shopping* greatly though it does not totally get rid of the issue. Though the Ethio-Austrian BIT uses only the incorporation criterion for defining company nationality, it mitigates the threat 'denial of benefit clause'. Basically, it's only this BIT which has incorporated the DOB clause among Ethiopia's investment treaties.[224] Some of these BITs on the other hand combine the incorporation tests with economic engagement. For example the Ethio-Malaysian BIT[225] and the Ethio-Swiss BIT[226] use "undertaking of economic activities" in the territory of contracting state to claim BIT benefits in the other party. Yet, the latter is more secured as it specifies the extent of the economic engagement. It stipulates the company shall operate its substantive economic activities in the territory of the home state. There is no objective yardstick to determine what constitutes substantive economic operation. However, the practice of other states is taking in to consideration of the tax return, number of permanent employees, major processing activities etc. This creates much genuine link between the company and the state concerned. The Ethio-Finland BIT particularizes the magnitude of the economic activity like that of the Ethio-Swiss BIT. However, as this test is applied as alternative to the company seat criterion, it's similar to the one between Ethiopia and Malaysia. The same problem persists

[224]Agreement between the Republic of Austria and the Federal Democratic Republic of Ethiopia for the Promotion and Protection of Investments (2005), Article 10

[225] Art 1 (1) (b) (ii)
[226] Art. 1 (1) (b)

in the case of the BIT between Ethiopia and Iran[227]. In addition, all of these BITs are still laid open to by the nationals and companies of the host states through '*mail-box'* companies. This is because, they do not have deterrence mechanism to avoid this problem as the nationality of the controllers and owners is not considered anywhere.

The third category encompasses those BITs which have low risk of *shopping*. This is on the fact that, they apply three nationality criteria at a time to define company nationality which makes the *shopping* complicated and less likely. The BITs are those treaties signed with Algeria, China, Denmark, Egypt, Equatorial Guinea, Libya, Russia, South Africa, Sudan, Sweden and Yemen. All these investment treaties employ three tests at a time respectively, the place of incorporation, the requirement of having seat, and undertaking substantial economic activities in the territory of the other contracting state. There exists a minor variation in the use of company seat and the undertaking of business activities as preconditions to claim nationality of such states.[228] However, there are still possibilities for the nationals/companies of the host state to switch the BITs protections in to themselves since the control test is not used in any place.[229] In the meantime, none of the BITs use the DOB clause which still dilutes their strength of avoiding *shopping* by persons of third state or the host sate itself.

To sum up, Ethiopia's bilateral investment treaties predominantly are characterized by unrestrictive definition of investor. The BITs also recognize many alternatives of investment including direct and indirect controls of shares and assets in companies. Many of BITs resemble first generation BITs model that adopt unrestrictive approach towards nationality of companies

[227] Ethio-Iranian BIT, n, 184, Art. 1 (2) (b)

[228] Some use "seat" while others employ "registered office, principal seat, or head office" all of which denote almost similar concepts. For instance, the Ethio-Russian BIT employs 'principal seat' whereas the Ethio Algerian BIT uses 'head office' to denote company seat. The rest of the list in this category use simply the word 'seat'. The same difference remains in the use of the third criterion: while some use 'substantial economic activities', others apply 'effective economic activities'. Some even apply the concept in its general sense by putting 'its economic activities' to refer that the largest share or the total business operation of the company at point should be taken place in the home state.

[229] The *Tokios Tokles* Case is a clear a manifestation of this whereby a foreign owned domestic company invoked a treaty between Ukraine and the Republic of Lithuania. In this the ICSID refused to pierce the nationality of the complainant. In similar set of facts, ICSID accepted the request of Argentina for piercing nationality in the TSA Spectrum in which the claimant invoked the Netherlands-Argentina. This shows how the ruling of the same tribunal blatantly varies in cases of similar set of facts and treaties. This that necessitates taking of care in defining the nationality of companies in investment treaties.

which lay them open to the problem of *treaty-shopping*. In particular, the vast majority of BITs define company nationality on the basis of the incorporation test. The manner of defining this test by itself reveals inconsistency linguistically as well as the parameters used to sort out the concept. This would be a ground for expansive interpretations by arbitration tribunals in times of disputes. There are some cases whereby the incorporation test is combined with company seat and carrying out of economic activities. However this is still ineffective with respect to *shopping* by the nationals. As the test does not answer the issue of shopping by holding companies from other states, the BITs are futile in this regard. The last element of these conditions is also soft as it's only few of the BITs which specify the extent of the economic activities to be undertaken in the state where the company is based in.

### 3.6. Potential Threats to Ethiopia out of the Exposure to *Treaty-Shopping*

Generally, the country apparently would face those damaging consequences attributed to the treaty gap discussed in the previous chapter. The erosion of reciprocity in BITs, multiplicity of legal claims, parallel proceeding, and those issues attributed to international investment arbitrations are by *mutatis mutandis,* concern Ethiopia's BITs. Those security policy threats, internationalization of domestic capital as well as the chilling effects of *treaty-shopping* on sustainable development would be equally challenges to the country's investment goals.

Just to add some specifics about Ethiopia's case the following points are vital. Ethiopia's BITs, are laid open to face the problems attributable to the meaning of the MFN clause and the umbrella clause. If we look at the first, the articulation of the MFN clause, many of the BITs demonstrate manifest incoherence and vagueness which might lead to the substantive-procedural dichotomy crisis[230]. The BIT between Ethiopia and Netherlands for example shows how the wording of the MFN clause is so general to encompass dispute resolution mechanisms. This extinguishes the precondition of exhausting local remedies even though this could be provided in the basic BIT which protects the investor primarily. In aforementioned BIT, the MFN clause is stated as:

[230] Dana H Freyer and David Herlihy, 'Most Favored Nation Treatment and Dispute Settlement in Investment Arbitration: Just How "Favored" is "Most Favored"? ' [2005], 'Foreign Investment Law Journal' 60

> "Each Contracting Party shall accord to such investments treatment which in any case shall *not be less favourable* than that accorded either to investment of its own nationals or to investments of nationals of any third State, whichever is *more favourable* to the national concerned. *[emphasis added]"*[231] This provision makes no distinction as to treatments to be accorded, especially, whether or not it covers procedural issues. Such vagueness leads to unwanted abusing this BIT in many ways. The BIT between the Belgian Luxemburg Economic Union and Ethiopia is also so general. It stipulates "In all matters relating to the treatment of investments, the investors of each Contracting Party shall enjoy national treatment or most-favoured nation treatment in the territory of the other Contracting Party."[232]

Similarly, the BIT between UK and Ethiopia also shows the same problem where by it includes Article 8 that deals with dispute settlement through the operation of Article 3(3).[233] Some of the country's BITs also have umbrella clause that may intensify the situation to deal with the MFN. The BIT signed with Germany, and those BITs signed with Denmark and Kuwait are few examples that contain umbrella clauses.[234]

Ethiopia is a member to Investment Agreement for the COMESA Common Investment Area which recognizes members' right to raise CSR as a defense against an investor from a member state in international investment arbitration tribunals. *Treaty-shopping* sweeps this opportunity as it creates the avenue for investors to bypass this right of host states in the agreement. This becomes hindrance to the country's regulatory windows, as well as obstacles to address ensure of sustainable development.

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[231] Ethio-Netherlands BIT, n, 192, Art. 3(2)

[232] Ethio-Belgian BIT, n, 203, Art. 4(1)

[233] Article 3(3) reads as "Except provided otherwise in this Agreement and for the avoidance of doubt, it is confirmed that the treatment provided for in paragraphs (1) and (2) above shall apply to the provisions of Articles 1 to 10 of this Agreement."

[234] Article 2(3) of the Ethiopia-Denmark BIT and article 3(3) of the Ethiopia-Kuwait BIT states: 'Each Contracting party shall observe any commitment it may have entered into with regard to investments of investors of the other contracting party. '

Most of Ethiopia's BITs are signed in the years between 1996 and 2009. Besides many of them have ten-fifteen years of duration. There are few as the Ethio-Kuwait BIT with thirty years, and those BITs signed with France, Finland and Sweden having twenty years of duration which commences from ratification. It thus follows that most have either expired or are closer to termination of their first time of duration.

Besides, almost all of Ethiopia's BITs have tacit renewal clauses. Accordingly when the initial duration period lapses before at least one of the contracting states fails to notify the other of its intention for termination, the treaty automatically renews for subsequently. Yet, this is subject to the right of each party to call for renegotiation or even unilateral termination. This is provided in the termination clause of all the country's BITs. Such clauses give the country chance to call the other party for renegotiation or unilaterally discontinue those BITs which have negative elements.

In connection to the problem dealt in this work, this opportunity gives the chance to reconsider the definitional clauses of all BITs. And if this is opted, more needs to be done on those BITs which have risk of expansive interpretation. In particular, much emphasis has to be given for BITs which use the incorporation test as company nationality standard.

# CHAPTER FOUR

# CONCLUSIONS AND RECOMMENDATIONS

## Conclusions

*Treaty-shopping* is a phenomenon by which investors not contemplated for coverage pierce in to a certain investment treaty with the goal of taking benefits there from. This is done by structuring investments by getting nationality of convenience, the nationality of any of the treaty parties. An investor makes arrangements to get the nationality of states which have best protective BITs signed with another state in which it has investments or plans to have so. Such structuring could be done either before or after the investment, in which tribunals do have contradicting decisions relative to the time aspect. Investors do this because, one, their home state does not have investment treaty with the target host state, or two, even if their home state has so, they think another BIT better protects their interest in the host state than the former. Most particularly, the MFN clause and international arbitration clauses are the major components of BITs for which investors exercise such techniques. The interpretation of the MFN, especially in relation to disputes settlement mechanism is one of the most disputed issues in international investment law. Cases are many, both supporting and against each side of the argument.

Definition of investors in investment treaties is the core issue behind investment treaties. There are two types of investors, natural persons and legal entities though the latter take the lion share. Definition of natural persons is almost always made on the basis of nationality except for there are few cases of using domicile or permanent residence. Nationality of natural persons is made based on the domestic legislation of each contracting parties. As far as companies are concerned, definition is determined by the nationality of the company too. As companies are fictitious beings, it is the mutual agreements of the contracting states in investment treaties used to delineate how their nationality should be reached at.

*Treaty-shopping* involves companies most and its implications are severe therein. This is attributed to the problem attached to corporate nationality. There is no one-fits-to all criterion for defining corporate nationality. Traditionally, companies took the nationality of the state where they were incorporated or where their seat situates. However, the use of these criteria lead to strange outcome as they were not effective to tackle new developments in international

investment law. These criteria gave rise to abusive practices by companies, *shopping* in this case. As a response to fill the gaps left by these parameters, the ownership/control test and the economic engagement tests flourished. Yet, these criteria often times are used to supplement the previous two than they are exclusively used.

Studies show definition of investors in general and companies in particular is the main factor for *treaty-shopping*. Generally, the more a BIT uses broader and unrestrictive approach to trace corporate nationality, the greater it will be hit by the phenomenon. Netherlands BITs are several times mentioned behind cases in international investment arbitrations owing to their unrestrictive definition of investor. The Netherlands became a base camp for more than twenty thousand *shell-companies* having no sincere connection with the country. The first and second generation Dutch BITs are characterized by using the incorporation test for defining nationality of companies. This became instrumental for the establishment of subsidiaries by oversea MNCs in the country, which subsequently penetrated in to the other treaty party and lastly turned out to be cause of trouble to host states. Argentina, Bolivia, Czech Republic, and Venezuela are states worst affected by *treaty- shopping* in relation Dutch BITs.

Scholars have a mixed views on the legitimacy of *treaty shopping* in international investment law. Some label it as abusive behavior whereas others denounce this saying the phenomenon is a normal business planning. International investment tribunals also share the same controversy. Cases are decided both in permissive and prohibitive conclusions.

The unquestionable fact setting aside the debate is there are practically proven consequences it bears on host states. It has damaging effects on the overall regulatory power of the host state. It erodes the principle of reciprocity as the investors of the host state may not get similar protections in the home state of the company that is engaged in the practice. Hence, it forces the host state to protect subjects which it has not foreseen, or not willing to protect, even which could be hostile to its welfare in some instances. Most importantly, given the MFN clause is unsettled so far in relation to its association with procedural rights as well as the *Umbrella Clause*, treaty-shopping poses exacerbated substantial danger. The host state may face simultaneous litigations resulting in vey sever consequences. Parallel proceedings in similar or different tribunals, multiple claims, compensations, costs, conflicting awards and long lasting bad images on the host state's investment regime are the major attributes of the problem. In

addition, it results in the internationalization of capital that would be otherwise be domestic. This among other things results in the subjection of the host state to international arbitrations by its own nationals which is nonexistent facility for domestic investors. Such abusive opportunities may also discourage domestic investment as investors prefer to be treated as foreigners because of those international standards of treatment found in the BITs. *Treaty-shopping* has also a chilling effect on the development of CSR as investors bypass human rights standards and environmental restrictions using treaty heaven.

*Treaty-shopping* is fundamentally attributed to definition of investors, particularly companies. Thus more needs to be done on the nationality of companies. Using a single criterion to delineate corporate nationality makes BITs bare to the problem. Hence the more criteria are cumulatively used, the lesser will be the vulnerability to the threats. Furthermore, the criteria of corporate nationality should presuppose the creation of genuine economic connection between the company and the contracting states. The last criterion discussed are good tools to combat the practice. There is also the so called DOB in BITs. This clause is a recently designed technique to prevent the problem. It is a clause which entitles the host state to deny protections to a certain group of investors based on some conditions. The conditions are usually the nationality of controllers of the investment and the lack of genuine connections between the company and the contracting states.

The central objective of this study was to critically observing Ethiopia's BITs vis-à-vis *treaty-shopping*. In so doing, the work highlighted some remarks on Ethiopia's efforts of liberalizing its economy, which *inter alia*, is reflected in the signing of around three dozens of BITs with other states. Currently the country has thirty two BITs, eight with African states and twenty four with states from out of Africa. Twenty one of these BITs have entered in to force whereas the rest are less of ratification. The structural organization of these treaties and the treatments offered there in show manifest similarity with other BITs practices. To be specific, almost all guarantee investor's rights to international standards of treatment, including NT, FSP, MFN and the right to international arbitrations settlement for investment disputes. The last two are the heart of investment treaties which gave rise to big controversy and skepticisms about investment treaties in general.

Definition of investors in general and companies in particular in Ethiopia's BITs resemble to BITs practices of other states which were worst hit by the phenomenon. The researcher, after thorough observation of twenty seven BITs, concluded that the treaties are boldly dissimilar with respect to nationality of companies. Some BITs are so general to embrace all types of business entities while others give some illustrations; some seem to be exhaustive while others make no distinction based on purpose or legal personality of the company in the home state. Ethiopia does not have a BIT Model. Yet, most BITs determine company nationality based on the classical criteria, the incorporation and company seat. The way such tests are crafted and the basis on which they are made significantly vary across BITs. In addition, these tests are used exclusively or in combination at times. The control test is given the least place in the country's BITs for determination of company nationality. Basically, the nationality of the owners of a company is ignored in all the BITs of the country except there are few instances that it's used to define overseas companies owned by nationals or homegrown companies of the contracting sates in all the BITs.

Because of unrestrictive definition of companies combined with lack of the denial of benefits clause, the country's BITs are affected by threats of problems in varying degree though. Based on their vulnerability, the BITs are divided in to three categories: those with higher risk, medium risk and low risk. Owing to the gaps, Ethiopia's BITs are potentially exposed to bear the harmful impacts experienced by other states. Lastly, the refresher recommends for renegotiation the countries BITs as most of them are signed in between 1996 and 2009 that they have ten to fifteen years of duration time that they are either expired or closer to expire. In doing so, focus must be given to defining companies as a proactive measure to combat the situation. More specifically, BITs to come head should not use the 'incorporation' criterion as the sole parameter for defining company nationality. In addition. The 'economic engagement' test should be strengthened in such a way that the BITs require strong economic connection between a company and a home state. Finally, the refresher also recommends for the insertion of DOB in subsequent BITs the country would sign.

## Recommendations

Based on the findings of this study, the researcher has reached at a conclusion that Ethiopia's bilateral investment agreements are affected by factors of phenomenon. The gravity of their vulnerability however is not identical that the steps to be taken also vary accordingly.

Ethiopia needs to renegotiate the BITs taking in to consideration of company nationality.

- ✓ The use of incorporation criterion as a sole standard of company nationality should be removed.
- ✓ The use of company seat as the only parameter of company nationality should also be eradicated.
- ✓ The economic engagement criterion should be redefined in such a way that the company has strong economic activities in the territory of the other BIT party in all the country's BITs.
- ✓ Objective criteria should be provided to define the strong or substantial economic activities, such as in terms the number of permanent employees, the amount of turn over, tax returns etc.
- ✓ Exclusionary clauses that deter nationals and/or companies of the host state must be added at the very definition of companies.
- ✓ The country's BITs should include the DOB clause.

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