Yukos Universal v. Russia: Shell Companies and Treaty Shopping in International Energy Disputes

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INTRODUCTION

In late 2009, an investment arbitration tribunal organized under the UNCITRAL Arbitration Rules before the Permanent Court of Arbitration released its Interim Award on Jurisdiction and Admissibility in the case of Yukos Universal Ltd. (Isle of Man) v. Russian Federation ("Yukos Universal"). The Tribunal, composed of three
prominent authorities on international investment law,2 held that it had jurisdiction under Article 26 of the Energy Charter Treaty3 to decide the merits of the claim filed by Yukos Universal Limited against the Russian Federation. The award, at 226 pages and over 600 paragraphs, constitutes a comprehensive examination of five separate jurisdictional issues debated extensively by the parties and involving the written opinions and testimony of no fewer than twenty-three additional legal experts.4

The Tribunal’s decision ensures that Yukos Universal has standing to have its allegations of expropriation heard and, in the case of a conclusive finding of liability, an award rendered in its favour.5 Considering the politically sensitive nature of the Yukos Universal saga and the large potential damages involved, this development is in itself noteworthy.6 However, the Yukos Universal Interim Award (“Award”) is significant for reasons which extend far past the specific circumstances of the ongoing Yukos dispute. In particular, the Award

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2 See id. The Arbitral Tribunal consisted of Chairman L. Yves Fortier, CC, QC, Judge Stephen M. Schwebel, and Dr. Charles Poncet. Id.
4 Russia presented nineteen experts while Yukos Universal presented four. Yukos Universal’s experts included Professor W. Michael Reisman of Yale Law School and Professor James Crawford of Cambridge University. See Yukos Universal, at ii.
stands as an unambiguous affirmation of two contested principles of international investment law concerning the jurisdiction of investment tribunals constituted under Article 26 of the ECT to decide claims brought by certain investors. First, the Award clearly affirms the decision of several previous investment tribunals that Article 1(7) of the ECT does not function to deny standing to shell companies incorporated under the laws of a signatory to the ECT in the absence of any extenuating circumstances. Second, the Award clearly affirms the decision of a previous investment tribunal that Article 17(1) of the ECT is unavailable to respondent states to deny an investor standing once the investor has already commenced arbitral proceedings.

This article will examine the ramifications of the *Yukos Universal* Award in these two respects. In particular, it will focus on the impact the reasoning in the Award has on the ability of firms operating in the international energy sector to access the protective provisions of the ECT even if they do not have any established operations in the territory of any of the treaty’s signatory states. The ECT is perhaps the most comprehensive and far-ranging international investment agreement concluded to date. It provides investors with a diverse array of protective guarantees designed to protect foreign energy investment from adverse governmental treatment and political risk. These protective guarantees are reinforced by the Treaty’s provision for investment arbitration before an independent arbitral tribunal where an investor alleges that the host state or related third parties have illegally interfered with its investments. Furthermore, the ECT has been signed by more states than any comparable multilateral investment treaty, with Asia and Europe being particularly well represented. These are invaluable attributes in an increasingly hostile international energy market in which a renewed cycle of resource nationalism has lead to increased tensions between private international energy firms and the energy-rich states and state-owned companies with whom they do business. As a result, the ECT is and is likely to

7 *Yukos Universal,* ¶¶ 411-417.
remain a highly desirable tool of investment protection for energy firms both within and without its immediate purview. This is likely to lead to continued treaty-shopping techniques of the type evidenced in Yukos Universal. It is therefore necessary to determine how far the ECT’s jurisdictional provisions can be stretched before being broken, both for the continued integrity of the ECT regime as well as for the benefit of international energy firms looking to take advantage of the ECT regime.

**PART I: THE YUKOS DISPUTE**

*The Facts of the Dispute*

The history of the Yukos saga invites the use of superlatives. Yukos Oil Incorporated (“Yukos Oil”) was originally created by presidential decree as a joint-stock company in 1993. In the time of its privatization in 1995-1996, it was a vertically integrated oil and gas company with a wide variety of operations in hydrocarbon exploration, production, refining, marketing, and distribution. In 2002, Yukos Oil ranked among the world’s ten largest oil and gas companies by market capitalization along with its three main production subsidiaries, Yuganskneftegaz, Samaraneftegaz, and Tomskneft. In 2003, Yukos Oil merged with Sibneft, another Russian based oil and gas company, and YukosSibneft was considered the world’s fourth largest oil producer following BP, Exxon, and Shell. Later that year Yukos

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11 *Yukos Universal*, ¶ 46.
12 *Id.*
13 *Id.*
14 *Id.*
Oil was poised to grow even larger as merger negotiations had been commenced with ExxonMobil and Chevron.\textsuperscript{15}

The talks did not get far. During the summer of 2003 Russian authorities began a series of criminal investigations into the operations of Yukos Oil.\textsuperscript{16} By the end of the year a number of the company's key officers were arrested, charged, and imprisoned on counts including embezzlement, tax evasion, money laundering, forgery and fraud.\textsuperscript{17} The arrests, investigations, interrogations, searches, and seizures continued through 2004, causing the majority of remaining senior Yukos Oil officers to permanently flee the country for a variety of overseas jurisdictions, including the U.K.\textsuperscript{18} Throughout this period Yukos Oil argued that its lawyers had been systematically obstructed from working on the corporation's behalf.\textsuperscript{19} It alleged that this interference with and harassment of its operations was motivated primarily by the participation of several of its highest officers, including Mikhail Khodorkovsky, in activities of the country's opposition parties.\textsuperscript{20} Yukos Oil argued that the primary intention of the campaign, regardless of Russia's representations, was to systematically nationalize the company's assets and operations.\textsuperscript{21}

Russia responded by arguing that these measures were warranted reactions to an extensive pattern of illegal activity engaged in by Yukos Oil intended to "to divert funds from Russian entities through tax fraud and embezzlement."\textsuperscript{22} It argued that the company's operations had been abused by an inner circle of senior officials who exploited various loopholes in Russian tax law to enrich themselves at the expense of the country's revenue authorities and the wider Russian public.\textsuperscript{23} These loopholes included special Russian low-tax zones and other tax schemes that were misused to transfer the corporation's revenues to offshore entities controlled by the inner circle.\textsuperscript{24} Russia further argued that the company was engaged in a massive transfer pricing scheme by which various petroleum products were sold to entities controlled by the Yukos Oil inner circle at below market prices for on-sale into the wider global market.\textsuperscript{25} Russia's allegations also included the commission of various corporate and criminal crimes by the

\textsuperscript{15} Id.
\textsuperscript{16} Id. ¶ 48.
\textsuperscript{17} Id. ¶ 49.
\textsuperscript{18} See id.
\textsuperscript{19} Id. ¶ 50.
\textsuperscript{20} Id. ¶ 48.
\textsuperscript{21} Id.
\textsuperscript{22} Id. ¶ 52.
\textsuperscript{23} Id. ¶ 58.
\textsuperscript{24} Id.
\textsuperscript{25} Id. ¶ 53.
inner circle. It argued that the group had illegitimately increased its majority shareholding by manipulating share prices to repurchase additional shares at discount from the secondary market. It also alleged that the company had engaged in a series of serious violent criminal acts including the murder, attempted murder, and assault of officials seeking to enforce Russian tax codes.

Regardless of the truth of these competing claims, the result was the same. Following Russia’s transition from a centrally planned socialist country to a free market economy during the 1990s and early 2000s, Yukos Oil had emerged as the largest oil company in the country and one of the largest in the world. By August 2006 it was bankrupt. Yukos Universal, a large shareholder of Yukos Oil incorporated under the laws of the Isle of Man in the United Kingdom, responded by initiating investment arbitration against Russia pursuant to Article 26 of the ECT. Yukos Universal alleged that the various criminal proceedings and taxation measures taken by Russia against Yukos Oil constituted breaches of various protective provisions of the ECT, including Russia’s obligation not to unlawfully undermine its investments. In particular, Yukos Universal argued that its shareholdings in Yukos Oil had been eviscerated by the Kremlin’s essentially expropriatory conduct.

The Energy Charter Treaty & Resource Nationalism

The ECT was signed in 1994 and remains the only binding multilateral agreement concerned specifically with inter-governmental cooperation and investment protection in the energy sector. It is a broad agreement that extends past investment protection and dispute resolution provisions—the limits of most Investment Treaties—to include provisions regarding energy trade, energy transportation

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26 Id.
27 Id. ¶ 54.
28 Id. ¶ 46.
29 Id. ¶ 56.
30 As noted, Yukos Universal was joined in this claim by Hulley and Veteran. See supra note 5.
31 Yukos Universal, ¶ 35.
32 See id. ¶ 369.
33 This special objective is clearly reflected in the text of the agreement, and Article 2 provides that the treaty’s purpose is to “promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.” ECT, supra note 3, art. 2.
34 For a thorough analysis of the typical characteristics and content of Bilateral Investment Treaties (BITs) and Multilateral Investment Treaties (MITs), see generally Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties (1995).
and transmission, energy competition, energy efficiency, and environmental protection. That said, the investment protection provisions remain the "cornerstone of the treaty" with its principle goal being to create "a level playing field for investments in the energy sector and to minimize the non-commercial risks associated with such investments."  

The ECT's investment protection provisions achieve this goal in two main ways. First, they establish a series of guarantees which prohibit "host" states from acting in a variety of ways that may illegitimately interfere with the operations of an investment project or business. These include the obligation to provide foreign investments fair and equitable treatment, the obligation not to treat the investment in an arbitrary or discriminatory fashion, the obligation to observe all obligations entered into with respect of the investment, the obligation not to unlawfully expropriate an investment, and the obligation to provide the investment with both national treatment and most favored nation treatment. Secondly, they provide investors from "home" states with standing to arbitrate alleged breaches of these protective provisions before independent arbitration tribunals capable of rendering binding awards against the "host" state. According to Article 26 such arbitration can occur before tribunals constituted

35 The unique nature of the ECT is explained by the economic, political, and historical conditions surrounding its negotiation and completion. Following the demise of the Soviet Union, international oil companies, particularly those from Western Europe, were intent on gaining access to the newly accessible energy resources of Russia and the other nations composing the Commonwealth of Independent States (CIS). So too were Western European states interested in increasing and diversifying gas supplies into their territories. However, while the countries of the former Soviet Union were viewed as one of the greatest remaining opportunities for the West and western oil companies to increase their oil access and reserves, these same places were simultaneously regarded as the areas of the highest political risk worldwide. The ECT was designed to tackle these concerns in a mutually beneficial fashion. See Thomas W. Waelde, International Energy Investment, 17 Energy L.J. 191, 212-14 (1996); Thomas W. Waelde & George Ndi, Stabilizing International Investment Commitments: International Law Versus Contract Interpretation, 31 Tex. Int'l L. J. 215, 217 (1996).


37 See ECT, supra note 3, arts. 10(1), 13.

38 Id. art. 10(1).

39 Id. art. 13.

40 Id. arts. 10(3), 10(7).

41 Id. art. 26.
under the auspices of the SCC or before an ad hoc tribunal constituted according to the UNCITRAL Arbitration Rules.\textsuperscript{42} In the event that both the "home" state of the investor and the "host" state in which the investment has been made are signatories of the ICSID Convention, arbitration may also take place before a tribunal constituted under the provisions of that instrument.\textsuperscript{43}

Although many consider the ECT to be the most ambitious and successful international investment treaty yet completed, many of the most prolific energy consuming and exporting countries are not parties to it.\textsuperscript{44} The United States was involved in the negotiations of the ECT and signed the Treaty in December of 1991 but declined to ratify it.\textsuperscript{45} The same is the case with Canada.\textsuperscript{46} As such, both countries have opted to maintain mere "observer" status regarding the treaty.\textsuperscript{47} This only gives them the right to attend all meetings of Charter members and to take part in discussions regarding the Treaty's future. Similarly, Australia has signed the ECT and is considered a member of the Charter but has yet to ratify it.\textsuperscript{48} Consequently, while these countries and others are home to many of the world's most internationally active oil and gas firms, these companies do not immediately benefit from the comparatively broad protective provisions of the ECT. This makes the Treaty a highly desirable but not immediately accessible tool of overseas oil and gas investment protection. In turn, this leads to various investment decisions which stress the bounds of the ECT's jurisdictional provisions. This was the case in Yukos Universal.

\begin{footnotesize}
\textsuperscript{42} Id.
\textsuperscript{43} Arbitration before an ICSID tribunal holds several advantages not matched by similar forums. First, awards rendered by an ICSID tribunal may not be vacated at the seat of arbitration (i.e. where the jurisdiction in which the award was rendered). Second, ICSID awards are not subject to review in the jurisdiction in which enforcement is sought. See Giorgio Sacerdoti, \textit{Investment Arbitration under ICSID and UNCITRAL Rules}, 19 ICSID REVIEW –FILJ (2004).
\textsuperscript{44} See Energy Treaty Charter Secretariat, supra note 9.
\textsuperscript{48} Other prominent observer nations include Venezuela, Nigeria, Saudi Arabia, Iran, China, and Indonesia. See id.
\end{footnotesize}
The Jurisdictional Arguments

Russia raised five separate jurisdictional objections before the tribunal;\(^{49}\) the first three of these arguments need not be discussed extensively here. Russia first argued that the ECT was inoperative in the circumstances because the Russian parliament had never ratified the ECT even though it had signed the treaty in 1994.\(^ {50}\) Second, Russia next argued that some, if not all, of Yukos Universal’s claims were barred from arbitration under the ECT by virtue of the taxation “carve-out” provisions of ECT Article 21.\(^ {51}\) Third, Russia alleged that Yukos Universal’s claims were barred by the “fork-in-the-road” provision of Article 26(3) of the ECT.\(^ {52}\) All of these are important arguments that occupied much of the tribunal’s time and attention. For example, the question of whether the ECT applied provisionally in Russia despite its non-ratification was given particularly thorough treatment, especially from the perspective of whether provisional application of an international treaty was consistent with Russia’s internal municipal law.\(^ {53}\) Each of these arguments was ultimately unsuccessful, however.\(^ {54}\) Furthermore, and much more importantly for the purposes of this investigation, none of these arguments is directly relevant to the practice of treaty shopping in the context of the ECT.

This is not the case with Russia’s final two objections. In this regard, Russia did not contest that Yukos Universal was an entity incorporated in the Isle of Man and as such was prima facie an investor of the United Kingdom, a signatory of the ECT.\(^ {55}\) Nor did Russia argue that the over fifty million shares in Yukos Oil held by Yukos Universal constituted an investment under the ECT. Rather, Russia focused on the circumstances of Yukos Universal’s incorporation in the Isle of Man, including the ownership structure behind Yukos Universal.\(^ {56}\) In total, it argued that these wider circumstances either had the effect of disqualifying Yukos Universal from benefitting from the ECT from the investment’s inception or gave Russia the ability to disqualify it from the benefits of the ECT in the circumstances at hand, or both.\(^ {57}\)


\(^{50}\) Id. ¶ 71(c).

\(^{51}\) Id. ¶ 579.

\(^{52}\) Id. ¶ 243(e).

\(^{53}\) See id. ¶¶ 290-398.

\(^{54}\) Id. ¶ 583.

\(^{55}\) Id. ¶ 72.

\(^{56}\) Id. ¶¶ 404-05.

\(^{57}\) Id. ¶ 406-07.
Russia emphasized that, while Yukos Universal owned over fifty million shares in Yukos Oil, it was part of a larger chain of legal entities and instruments not properly British in character. It highlighted that Yukos Universal was wholly owned by GML, a company registered in Gibraltar whose principle business activity was conducting investment activities through wholly-owned subsidiaries. Further, Russia alleged that the shares of GML were held by a series of trusts created in Guernsey whose beneficiaries were a number of Russian nationals and former senior executives of Yukos Oil and its subsidiaries, including Mr. Khodorkovsky. As such, while Yukos Universal was clearly a U.K. investor on paper, a more substantial investigation of the company clearly revealed that the corporation was a mere appendage of a much larger investment scheme ultimately owned and controlled by Russian nationals rather than truly foreign investors. Thus, Russia argued that it was inappropriate for Yukos Universal to have access to the ECT, a multilateral investment treaty designed primarily to safeguard foreign investment conducted by investors from one signatory in the territory of another signatory.

PART 2: ECT Article 1(7) AND SHELL COMPANIES

Introduction to ECT Article 1(7)

In order to establish standing under the ECT to bring an investment arbitration claim, a purported investor must meet two fundamental tests. First, it must prove that it has made an “investment” as recognized by the Treaty. This is determined by ECT Article 1(6) which captures a broad range of legal assets and interests, including “any right conferred by law or contract or by virtue of any licenses and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.” Secondly, it must prove that it is an investor as recognized by the Treaty. This is determined by ECT Article 1(7). It defines “investor” to mean:

“(a) with respect to a Contracting Party:


58 Id. ¶ 463.
59 Id.
60 Id. ¶ 483.
61 Id. ¶ 407.
62 Id. ¶ 433.
64 ECT, supra note 3, art. 1(6)(f).
(ii) a company or other organization organized in accordance with the law applicable in that Contracting Party." As such, the plain text of ECT Article 1(7) provides that a company organized in accordance with the laws of a Contracting Party will be considered an "investor" for its purposes.

The Arguments of the Parties

Russia argued that the provisions of Article 1(7) are not as simple as they might at first appear. While Article 1(7) might seem to limit its inquiry to whether a purported investor is lawfully constituted in an ECT Contracting State, other principles of international law as well as various other international law instruments require that any inquiry into the standing of an investor go further. Russia argued that the ECT was designed to provide for the arbitration of disputes between investors national to one signatory and the government of a second signatory. As such, Russia argued that Yukos Universal was not entitled to the protections of the ECT as it was a shell company owned and controlled by Russian oligarchs and because it did not wield any effective ownership or control over the shares in question. It argued that the incorporation and insertion of Yukos Universal into the wider Yukos corporate chain should not be allowed to give Russian nationals the right to bring a claim against their own government under an international treaty when the shell company was created for no other discernable "bona fide" purpose.

Yukos Universal responded by arguing that Russia was unnecessarily and illegitimately complicating the issue before the Tribunal. Because Yukos Universal was organized in accordance with the laws of the Isle of Man, there remained nothing else for the Tribunal to consider. Towards this end Yukos Universal argued that the Treaty said and did nothing that could compel Tribunals to conduct an examination of the nationality of the shareholders standing behind an otherwise qualified investor. Rather, it claimed, "there is no basis for interpreting Article 1(7) in any way other than pursuant to its plain,

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65 ECT, supra note 3, art. 1(7). ECT Article 1(7) is wide in its use of the term "organized" rather than "incorporated." As discussed by Dominique D'Allaire, this is a more general term capable of capturing entities other than corporations such as joint ventures, partnerships, and associations. See Dominique D'Allaire, The Nationality Rules Under the Energy Charter Treaty: Practical Considerations, 10 J. World Investment & Trade 39, 42 (2009).
66 Yukos Universal, ¶ 406.
67 Id. ¶ 71(46).
68 Id. ¶¶ 71(42), 71(44).
69 Id. ¶¶ 71(42), 71(44), 407.
70 Id. ¶ 408.
71 Id.
express terms.” To impose any additional standard would be to directly violate the express terms agreed upon by the Contracting States. Therefore, Yukos argued that “it is not for [the] Tribunal to ignore the express language of the Treaty itself” and that “[e]xpress treaty language cannot be overridden by alleged general principles of law.”

The Decision of the Tribunal

The Tribunal went about its decision in an orderly manner, noting the following facts. Yukos Universal was incorporated in the Isle of Man on September 24, 1997. The United Kingdom (U.K.) had extended its ratification of the ECT to the Isle of Man, which is considered by U.K. law to be a Crown Dependency. Finally, Yukos Universal remained incorporated under the laws of the Isle of Man at the date it filed its claim pursuant to ECT Article 26.

Turning to Article 1(7), the Tribunal highlighted that Article 31 of the Vienna Convention on the Law of Treaties requires that “a treaty must be interpreted first on the basis of its plain language.” With this in mind, the Tribunal then held that “[o]n its face, Article 1(7)(a)(ii) of the ECT contains no requirement other than that the claimant company be duly organized in accordance with the law applicable in a Contracting Party.” In other words, “in order to qualify as a protected Investor under Article 1(7) of the ECT, a company is merely required to be organized under the laws of the Contracting Party.” It thus found that, as Yukos Universal was so organized, it satisfied Article 1(7) and little else needed to be said. In fact, in the circumstances the Tribunal was “not entitled, by the terms of the ECT, to find otherwise.”

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72 Id.
73 Id. ¶ 409.
74 Id. ¶ 72(22).
75 Id. ¶ 404.
76 Id. ¶ 405.
77 Id. ¶ 404. Yukos Universal filed its Notice of Arbitration on 3 February 3, 2005. Id.
78 Id. ¶ 411.
79 Id.
80 Id.
81 Id. ¶ 413.
PART 3: ECT ARTICLE 17(1) AND SHELL COMPANIES

Introduction to ECT Article 17

Article 17 is the final article of Part III of the ECT and provides for the “Non-Application of Part III in Certain Circumstances.” Part III of the ECT establishes the various protective guarantees host states extend to foreign enterprises that invest in their territory. Article 17 specifies that:

Each Contracting Party reserves the right to deny the advantages of this Part to:
(1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.

Consequently, ECT Article 17 gives contracting state parties the power to deny the advantages of the Treaty to investors if they are “owned” or “controlled” by a national of a third state and if the investor has “no substantial business activities” in the area of the contracting party in which it is organized. However, Article 17 does not clearly outline the conditions and circumstances in which an ECT signatory can properly exercise this authority.

The Arguments of the Parties

Russia essentially argued that, as Article 17 does not impose any conditions on its exercise, it is only reasonable to conclude that the Article can be exercised at any time by a signatory at its complete discretion. As such, Russia purported to affirmatively employ the provision during the course of its arguments to immediately deny all benefits of the ECT to Yukos Universal, its beneficial owners, “and every one of their offshore shell companies and structures.” Russia argued that no legitimate objection to this conclusion could be made as Article 17 should put the burden of compliance on the investor rather than on the host state. In other words, Article 17 functions to require shell companies coming within its scope to “obtain a commitment from the host State that it will be treated as protected investors.” To interpret the Article otherwise would be to impose an impossible burden on host states. Russia further maintained that to do so would be to

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82 ECT, supra note 3, art. 17.
83 ECT, supra note 3, art. 17(1).
84 Id.
85 Yukos Universal, ¶¶ 445-47.
86 Id. ¶ 447.
87 Id. ¶ 446.
88 Id. ¶ 452.
impose the burden of identifying whether each and every investment entering the country had substantial business activities in its purported home jurisdiction.\textsuperscript{89}

Yukos Universal countered that the language of Article 17 provides only that each signatory “reserves the right to deny the advantages” of the ECT to purported shell companies or holding companies.\textsuperscript{90} In this regard it relied on the jurisdictional ruling of the Tribunal in \textit{Plama Consortium Ltd. v. Republic of Bulgaria}, which distinguished between the existence of a right and the exercise of that right.\textsuperscript{91} Yukos Universal also relied on the expert opinion of Professor James Crawford, who had argued that the notion that Article 17 requires each individual investor to obtain express assurance of protection was “plainly not the intention” of the ECT.\textsuperscript{92} As such, Yukos Universal argued that Article 17 required that a host state give an investor reasonable notice before exercising its rights to deny the benefits of the ECT to that investor.\textsuperscript{93} It then stated the language and the intent of the ECT insured that the legitimate exercise of Article 17 was incapable of having retrospective effect.\textsuperscript{94} If the drafters of the ECT had intended otherwise they would have specifically provided as such in the Treaty’s terms.\textsuperscript{95}

\textbf{The Decision of the Tribunal}

The Tribunal began its decision by acknowledging that Article 17 is not technically a matter of jurisdiction but rather of the merits of the case.\textsuperscript{96} Stated differently, it acknowledged that Article 17 is properly about whether the investor is entitled to protection, not whether a tribunal has authority to decide the case. Thus, it is a matter properly left to the merits phase of arbitration rather than one appropriate for a jurisdictional hearing. However, the court noted that because the parties had treated Article 17 as a matter of admissibility in their submis-

\begin{enumerate}
\item \textit{Id.}
\item \textit{Id.} \textsuperscript{4} 448.
\item \textit{Id.} \textsuperscript{4} 449 (citing \textit{Plama Consortium Ltd. v. Republic of Bulgaria}, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 44 I.L.M. 721, 745 (Feb. 8, 2005).
\item \textit{Id.} \textsuperscript{4} 448.
\item \textit{Id.} \textsuperscript{4} 450 (citing \textit{Plama}, 44 I.L.M. at 746).
\item \textit{Id.} (citing \textit{Plama}, 44 I.L.M. at 746).
\item \textit{Id.} \textsuperscript{4} 454.
\item \textit{Id.} \textsuperscript{4} 441. The same determination was made by the Tribunal in \textit{Plama v. Bulgaria}. See \textit{Plama}, 44 I.L.M. at 743-44. Note, however, that not all commentators agree with this interpretation. See Laurence Shore, \textit{The Jurisdiction Problem in Energy Charter Treaty Claims}, 10 Int’l Arb. L. Rev. 58, 63 (2007) (arguing that it is plausible that Article 17 “constitutes a jurisdictional consideration for an arbitral tribunal”). Note also that the distinction is not a trivial one. See Hober, \textit{supra} note 36, at 347.
\end{enumerate}
sions, the interests of judicial economy would be better served if it were addressed in the immediate proceedings.97

Turning towards the substance of Article 17, the Tribunal first highlighted that Article 17 does not outright prohibit shell companies from having access to the ECT.98 Had the drafters of the ECT wished to do so, the Tribunal opined, they easily could have.99 Consequently, the Tribunal determined that, rather than absolutely outlaw shell companies, Article 17 functions merely to “reserve[] the right” of ECT Contracting Parties to deny the advantages of Part III to such companies.100 It held that, in order to deny the benefits of the ECT to shell companies controlled by nationals of a third party state, a Contracting Party must affirmatively exercise its Article 17 right.101 Most importantly, the Tribunal could identify no such exercise by Russia material to the dispute at hand.102 It recognized that Russia had purported to exercise Article 17 in its submissions.103 However, it held that this action was of no consequence to Yukos Universal because such an exercise of Article 17 could only be prospective in nature and thus could not affect the standing of an investor whose investment dispute predated the announcement.104 The Tribunal found that such retrospective application of Article 17 would “be incompatible ‘with the objectives and principles of the Charter’” paramount among which are the “‘Promotion, Protection and Treatment of investments’ as specified by the terms of Article 10 of the Treaty.”105 As such, the Tribunal held that, while Russia’s purported exercise of Article 17 might function to prohibit future ECT arbitrations launched by shell companies organized in the United Kingdom, Yukos Universal’s ECT arbitration claim was free to proceed.106

97 Yukos Universal, ¶ 443.
98 Id. ¶ 456.
99 Id.
100 Id.
101 Id.
102 Id. ¶ 456-59. The Tribunal also quickly dismissed Russia’s argument that an indirectly related piece of national legislation dealing with the characterization of foreign investors could constitute an exercise of Article 17 because it did not expressly refer to the ECT while the ECT in no way provided for it.
103 Id.
104 Id. ¶ 458.
105 Id.
106 Id. ¶ 459.
PART 4: ANALYSIS AND IMPLICATIONS

Article 1(7)

When Russia argued that Yukos Universal was not an investor under the ECT because it was a shell company, it invoked what has become a familiar contention in investment arbitration case law. This argument begins with the premise that the fundamental purpose of international investment protection treaties such as the ECT is to afford protection to investors of one signatory who conduct investments in the territory of a second signatory. This argument next holds that this fundamental purpose can be abused in two circumstances. First, where nationals of a particular state incorporate a shell company in another state solely for the goal of securing the protection of an investment treaty concluded by that country with the investor’s home state. Second, where nationals of a third state incorporate a shell company in a state solely for the purpose of securing the protection of an investment treaty concluded by that country with the host state in which the investor plans on making its investment.

In Yukos Universal, Russia objected to the first of these two practices. Namely, it objected to the fact that a holding company was used by Russian nationals to bring an international claim against their own country. However, the provisions of the ECT make it equally as likely that the second situation could have occurred. For example, instead of being controlled by Russian nationals, Yukos Universal could have been used by an American or Canadian company to bring an ECT action against Russia even though neither of those countries are ECT signatories. This would have been possible if the American or Canadian company had attained control of Yukos Universal prior to the onset of the dispute. Although different, each situation involves the expansion of the Treaty’s protections to investors beyond its immediate ambit through the use of a shell company. Furthermore, each situation is vulnerable to criticism by those who oppose such supposed “treaty shopping” techniques.

Where investors of a host state use a shell company in a second state with whom the host state has signed an investment treaty to gain protection under that treaty, it is alleged that the treaty has been abused to provide for international investment arbitration where the dispute is in fact essentially domestic in nature. Critics find several problems with this state of affairs. First, they highlight that investment arbitration is unnecessary in these circumstances because the investor should not face any undue prejudice by proceeding in the local courts of the state in question. This criticism reflects the fact that one

107 Id. ¶ 407.
108 Id.
of the underlying purposes behind the investment treaty regime is to give foreign investors the ability to pursue claims before an independent international arbitration tribunal, lest they fear they would face significant prejudice bringing similar claims against a host state in that state’s own courts.109 Secondly, critics highlight that local investors who channel their otherwise domestic investments through foreign conduits are not in fact importing any capital into the country that was not already there.110 This criticism reflects the fact that another underlying purpose behind the investment treaty regime is to provide protection to foreign investors in the hope of attracting foreign capital into the country to spur increased economic growth and development.111

Where investors of a third state use a shell company established in a country that has signed an investment treaty with a host state in which the investor intends to expand its operations in order to gain access to the protection of that treaty, it is alleged that the treaty has been abused in a different fashion. Here it is alleged that the investor has “freeloaded” onto a treaty that was not properly intended to apply to the investor.112 Thus, while the investor or capital invested might be foreign, the result is nonetheless adduced to be illegitimate because the investor gained access to protective provisions for which its home state did not have to make any corresponding sacrifices.113 This violates the principle of reciprocity at the heart of all investment treaties whereby each signatory sacrifices aspects of its sovereign immunity by giving certain causes of action to foreign investors investing in their territory.114 This sacrifice allows the nationals of each signatory to benefit from the same waivers of sovereign immunity when investing in the territories of the other treaty signatories.

A growing number of investment tribunals have had to deal with these scenarios. For example, the Tribunals in Tokios Tokelés v. Ukraine115 and Rompetrol v. Romania116 were both faced with claims

111 See id. ¶¶ 3-5.
112 See Jagusch & Sinclair, supra note 63, at 100.
113 Id.
115 Tokios Tokelés v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶¶ 1-3 (Apr. 29, 2004).
116 Rompetrol Group N.V. v. Romania, ICSID Case No. ARB/06/3, Decision on Respondent’s Preliminary Objections on Jurisdiction and Admissibility, ¶ 50 (Apr. 18, 2008).
brought by shell companies effectively controlled by investors national to the host state being brought to arbitration. On the other hand, the Tribunals in Mobil v. Venezuela, ADC v. Hungary, and Aguas del Tunari v. Bolivia were all faced with claims brought by shell companies effectively controlled by investors national to a third party state that was not a signatory to the investment treaty pursuant to which the arbitration claim was brought. This has lead to an increasingly robust body of investment arbitration case law dealing with “treaty-shopping” through the use of shell companies. Furthermore, unlike other areas of international investment arbitration case law, this case law has developed in a rather uniform fashion.

These tribunals have adopted a literal approach to the interpretation of nationality requirements in international investment treaties. In other words, they have held that, regardless of the other circumstances surrounding the corporate background of the investor in question, the interpretation and application of the investment treaty at hand must first and foremost be conducted pursuant to the provisions of Article 31 of the Vienna Convention on the Law of Treaties (“VCLT”). This Article provides that a “treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” As such, these tribunals have held that it is not for them to “to substitute [their] views of the definition of the term ‘investor’ to that of the Contracting Parties to a BIT” (bilateral invest-

117 Mobil Corp. et al. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, Decision on Jurisdiction, (June 10, 2010).
118 ADC Affiliate Ltd. et al. v. Republic of Hungary, ICSID Case No. ARB/03/16, Award of the Tribunal, ¶¶ 334-35 (Oct. 2, 2006).
121 See D’Allaire, supra note 65, at 47-50. But see Markus Burgstaller, Nationality of Corporate Investors and International Claims Against the Investor’s Own State, 7 J. WORLD INVESTMENT & TRADE 857 (2006) (arguing that international investment protection should be granted only if there is a genuine link between the organization and the state of incorporation); Robert Wisner & Nick Gallus, Nationality Requirements in Investor-State Arbitration, 5 J. WORLD INVESTMENT & TRADE 927 (2004) (providing examples of the complexities of determining the nationality of investors in international investment treaties).
123 Id. at Article 31(1).
They have held that to do so would be “tantamount to setting aside the clear language agreed upon by the treaty Parties” in favour of external considerations in clear violation of VCLT Article 31. Consequently, they have rejected the assertion that “economic reality should prevail over formal legal structure when it comes to the interpretation of . . . BITs for the purpose of ascertaining the nationality of corporate investors.”

The analysis of the Tribunal in Yukos Universal is a mirror reflection of this approach. In this regard it is also a clear affirmation of the plain meaning doctrine. As discussed, the Yukos Universal Tribunal began its analysis by noting that Yukos Universal was at all relevant times organised according to the laws of the Isle of Man. It then referred to Article 31 of the VCLT to decide that the plain language and meaning of Article 1(7) of ECT had been satisfied by such corporate organization. Moreover, because Yukos Universal organized in accordance with the laws of the Isle of Man and satisfied the requirements of ECT Article 1(7), the Tribunal held that it was “not entitled” by the Treaty to come to any conclusion other than that Yukos Universal had standing to pursue its claim as an investor of the United Kingdom. It recognized that “principles of international law” have an “unquestionable importance in treaty interpretation.” However, the Tribunal professed that it knew of “no general principles of international law that would require investigating how a company or another organization operates when the applicable treaty simply requires it to be organized in accordance with the laws of a Contracting Party.”

This is not to say that the Yukos Universal Tribunal was entirely comfortable with its ruling. Referring to Saluka Investments BV v. Czech Republic, it acknowledged that the plain meaning doctrine can easily lead to abuses by entities intent on treaty shopping. In that case the Tribunal held that it had:

some sympathy for the argument that a company which has no real connection with a State party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the

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124 Rumeli Telekom A.S. et al.v. Republic of Kazakhstan, ICSID Case No. ARB/05/16, Award, ¶ 190 (July 29, 2008).
125 Rompetrol, ¶ 85.
126 Id.
127 Yukos Universal, ¶ 404.
128 Id. ¶ 411.
129 Id. ¶ 435.
130 Id. ¶ 415.
131 Id.
laws of that State, should not be entitled to invoke the provisions of that treaty. 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’.\footnote{Saluka Investments BV (The Netherlands) v. Czech Republic, Partial Award, ¶ 240 (Mar. 17, 2006).}

However, like the tribunal in Saluka, the tribunal in Yukos Universal ultimately decided that to purposefully disregard the plain meaning of a treaty’s text would be an even greater injustice than any purported instance of “treaty shopping.” It essentially held that “the predominant factor which must guide the . . . exercise of its functions is the terms in which the parties to the Treaty now in question have agreed to establish the Tribunal’s jurisdiction.”\footnote{Id. ¶ 241.} Further following the reasoning in Saluka, the Yukos Tribunal essentially held that it could not “in effect impose upon the [state] parties [to the treaty] a definition of ‘investor’ other than that which they themselves agreed”\footnote{Id.} and that it “was not open to” the Tribunal to “add other requirements which the parties could themselves have added but which they omitted to add.”\footnote{Id. ¶ 241.}

The Yukos Universal Tribunal quoted the decision of the Saluka Tribunal at length.\footnote{Id. ¶ 241.} In doing so, it plainly revealed its own concerns that the plain meaning approach, when coupled with definitions of “investor” that require no more than organization in accordance with the laws of a home state, creates opportunities for treaty shopping. Nonetheless, it ultimately held that international law, including the VCLT, does not allow arbitral tribunals “to write new, additional requirements—which the drafters did not include—into a treaty, no matter how auspicious or appropriate they may appear.”\footnote{Id. ¶ 414.} The tribunal recognized that, because of the structure of the investment, it was possible that Yukos Universal was not responsible for the injection of any foreign capital into the Russian economy. In doing this, the Tribunal also recognized that the ECT was intended to promote cross-border investment in the energy sector between western European states and successor states of the USSR.\footnote{Id. ¶ 415.} However, the tribunal rejected Russia’s assertion that the definition of investment

\footnote{Saluka Investments BV (The Netherlands) v. Czech Republic, Partial Award, ¶ 240 (Mar. 17, 2006).}
\footnote{Id. ¶ 241.}
\footnote{Id.}
\footnote{Id. ¶ 241.}
\footnote{Yukos Universal, ¶ 414.}
\footnote{Id. ¶ 415.}
\footnote{Id. ¶ 434.}
under the ECT necessarily required an injection of foreign capital. While it implied that such a foreign injection should be expected, the Tribunal nonetheless concluded that it is "bound to interpret the terms of the ECT not as they might have been written so as exclusively to apply to foreign investment but as they were actually written."140

The Yukos Universal Tribunal was correct to rely on the Article 31 of the VCLT in interpreting the ECT and to find that the VCLT requires that treaties be interpreted according their plain meaning in light of their object and purpose. It was also correct to find that a plain reading of Article 1(7) of the ECT requires no more than a company be incorporated in a state party to the treaty to have standing to bring an ECT claim, regardless of the consequences of this approach.

Treaties use various definitions to determine investor standing. Besides jurisdiction of organization, these include place of management, place of control, or a combination thereof.141 However, as noted by the Yukos Universal Tribunal, "the State of incorporation is the most common method of defining the nationality of a company."142 This is not a coincidence. States know well the options available to them to delimit nationality. Furthermore, the consequences of these different choices have been thoroughly discussed and debated for some time.143 It is therefore reasonable to assume that they clearly understand the ramifications of their decisions on this point as far as treaty shopping practices are concerned.

It is also important to note that there are advantages to the "organizational" definition of investor nationality which go a long way toward explaining why this standard is so often adopted in investment treaties. Chief among these is that it establishes a bright line test that is subject to clear application and which avoids difficult qualitative and quantitative determinations. Where the "organizational" test is used it is unnecessary to examine any inherently complex concepts such as what constitutes "management." So too is it unnecessary to parse the meaning of control, including whether this includes de facto

139 Id. ¶ 432.
140 Id. ¶ 435.
142 Yukos Universal, ¶ 416. In so doing it echoed the rulings of the Tribunals in Rompetrol v. Romania and Tokios Tokelés v. Ukraine. See Rompetrol Group N.V. v Romania, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, at ¶ 83 (Apr. 18, 2008); Tokios Tokelés v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction, ¶ 63 (Apr. 29, 2004).
143 See Barcelona Traction, Light & Power Co. (Belg. v. Spain), 1970 I.C.J. 3 (Feb. 5).
control alongside *de jure* control as well as the effect of other possible sources of control such as parent companies and other affiliates, whether domestic or foreign. Finally, while it is true that the "organizational" definition of nationality may result in situations which conflict with other parts of a treaty, such as the idea that its purpose is to attract investment from counterparty, this is not necessarily fatal. As stated by D'Allaire, although "[p]rovisions of an investment treaty shall be interpreted in light of the treaty's object and purpose, . . . this does not mean that any consequence of the application of a provision must necessarily be fulfilling the intended purpose." 144 Furthermore, should ECT signatories desire to prohibit the practice of treaty shopping made possible by the plain construction of Article 1(7), this course of action always remains available to them pursuant to Article 17(1).145

**Article 17(1)**

Article 17 of the ECT is not a unique provision and has counterparts in other international investment treaties.146 These provisions are usually collectively referred to as "denial of benefits" clauses.147 "Denial of benefits" clauses such as Article 17(1) are inserted into investment treaties for two reasons. First, "to maintain reciprocity or asymmetry with regard to the benefits arising out of the protection offered by investment treaties," and second, to "exclude from the protection of the treaties the so-called 'shell companies.'"148 In other words, the purpose of denial of benefits clauses such as ECT Article 17(1) is to prevent treaty shopping through the incorporation of shell companies or similar corporate vehicles.149 While "denial of benefits" clauses are relatively common, case law addressing them is sparse both in number and content. *Yukos Universal* was the second case to examine the ECT Article 17(1) "denial of benefits" clause. The first instance occurred in *Plama*. Other tribunals have looked at "denial of benefits" clauses, but in the context of different bilateral investment treaties and for the most part very fleetingly.150 Consequently, the treatment given to ECT Article 17(1)

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144 D'Allaire, *supra* note 65, at 50.
145 ECT, *supra* note 3, arts. 1(7), 17(1).
147 See RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 55 (OXFORD UNIV. PRESS, 2008).
149 *Id.* at 1313; *see also* Jagusch & Sinclair, *supra* note 63, at 90-91.
150 For example, in [*Waste Management v. Mexico*](https://www.wnaw.com), a NAFTA Chapter Eleven case, the Tribunal mentioned that Treaty's denial of benefits clause merely to note that
in Yukos Universal and Plama is of relatively significant importance. The tribunals in these cases expended considerable energy scrutinizing Article 17(1). They also arrived at near identical interpretations and applications of it. The result is the beginning of a relatively uniform body of case law flushing out the full dimensions of ECT Article 17(1). The result is also an interpretation which is, generally speaking, favourable to the interests of shell companies and their owners and controllers. However, the rulings delivered in Yukos Universal and Plama are far from a comprehensive exposition of Article 17(1) and much of its application has yet to be decisively determined.

The construction of Article 17(1) poses a number of questions. These include queries regarding how the clause must be exercised, when the clause can be legitimately exercised, and the effects of its exercise. As discussed, the Tribunal in Yukos Universal posited several answers to these questions. It held that Article 17(1) did not function to automatically deny shell companies standing under the ECT.\textsuperscript{151} It found that Article 17(1) must be affirmatively exercised by an ECT signatory.\textsuperscript{152} It also held that once exercised, Article 17(1) will only have prospective and not retrospective effect.\textsuperscript{153} In addition, the Yukos Universal Tribunal highlighted the two substantive conditions inherent to Article 17(1) that must be met for a purported exercise of the clause to be effective.\textsuperscript{154} First, the legal entity in question “must be owned or controlled by citizens or nationals of a third State.”\textsuperscript{155} Secondly, the legal entity in question “must have no substantial business activities in the place in which it is organized.”\textsuperscript{156}

The analysis of the Yukos Universal Tribunal closely follows the ruling of the Tribunal in Plama.\textsuperscript{157} In that case, the Tribunal was faced with a claim made by an entity incorporated in Cyprus – Plama Consortium Limited – against Bulgaria. Plama had no substantial

\textsuperscript{151} Yukos ¶ 456.
\textsuperscript{152} Id.
\textsuperscript{153} Id. ¶ 458.
\textsuperscript{154} Id. ¶ 460. The Tribunal held that because Article 17 had not been correctly exercised by Russia in relation to Yukos Universal, there was no need, strictly speaking, for it to establish whether these two elements were satisfied in the circumstances at hand. See id. ¶ 461.
\textsuperscript{155} Id. ¶ 460.
\textsuperscript{156} Id.
\textsuperscript{157} Plama Consortium Ltd. v. Republic of Bulgaria, ICSID Case ARB/03/24, Decision on Jurisdiction, 44 I.L.M. 721 (Feb. 8, 2005).
business activities in Cyprus, and, as such, the Respondent sought to deny it the benefits of the ECT pursuant to Article 17(1). The Plama Tribunal held that "the existence of a ‘right’ is distinct from the exercise of that right" and that, as a result, a "Contracting Party has a right under Article 17(1) ECT to deny a covered investor the advantages under Part III; but it is not required to exercise that right; and it may never do so." In this regard, the Plama Tribunal compared the wording of Article 17(1) to different "denial of benefits" clauses in other bilateral investment treaties which automatically deny the benefits of those treaties to shell companies owned or controlled by investors of third states. It then held that Article 17 constitutes at best "only half a notice" that requires something more to be effectual. The Plama Tribunal also held that the object and purpose of the ECT—to establish a legal framework "to promote long-term cooperation in the energy field"—made it clear that any exercise of Article 17(1) could only be prospective, and not retrospective, in effect. The confluence of these decisions is noteworthy. Together they represent the nascent stages of a broader and firmer body of investment arbitration case law. Under this body of law, ECT Article 17(1) will not deny shell companies standing to bring claims under the Treaty until it has been positively exercised by the host into which the shell companies have invested. This interpretation is directly benefits investors from states that are not a party to the ECT but who are nonetheless interested in accessing its protective terms. It provides them the opportunity to access the ECT through the incorporation of a shell company in the territory of an ECT signatory state. It also provides that this strategy will be effective until Article 17(1) is positively exercised by the host state. This interpretation directly complements the interpretation of Article 1(7) adopted by the Yukos Universal Tribunal. It effectively opens the ECT to entities and investors the world over with the means to incorporate a shell company in any ECT signatory, from the United Kingdom to Kazakhstan.

158 Id. at 728.
159 Id. at 745. Like Russia, in Plama Bulgaria argued that Article 17(1) was intended to confer on signatories “a direct and unconditional right of denial which may be exercised at any time and in any manner.” Id. at 743. Bulgaria also argued that its decision under Article 17(1) was effectively unreviewable by the Tribunal because if an investor was denied access to Part III of the ECT, then it was also denied access to Part V of the ECT, that part of the treaty providing for the arbitration of disputes. See id. at 742-43.
160 Id. at 745 (citing ASEAN Framework Agreement on Services, art. VI, Dec. 15, 1995).
161 Id.
162 ECT, supra note 3, art. 2.
163 Plama, at 746.
That said, it is critical to note there is no strict principle of
\textit{stare decisis} in international investment arbitration. The majority
of investment tribunals profess that, “subject to compelling contrary
grounds,” they have a duty “to adopt solutions established in a series
of consistent cases.”\footnote{164} These Tribunals locate such a duty in the need
to “to contribute to the harmonious development of investment law”
and thereby “meet the legitimate expectations of the community of
States and investors towards the certainty of the rule of law.”\footnote{165} How-
ever, a minority of arbitrators understand it to be their duty “to decide
each case on its own merits, independently of any apparent jurispru-
dential trend.”\footnote{166} Thus, while future investment tribunals will likely
give good weight to the decisions rendered in \textit{Yukos Universal} and
\textit{Plama}, they will not be required to adhere to them. Furthermore, as
these cases remain limited in number, it remains easier for a future
tribunal to break from the trend they establish than if the case law
had been more robust.\footnote{167}

It is also important to note that questions can be asked of the
decisions made in these cases. It is a plausible argument that the
mere existence of Article 17(1) is enough to put prospective investors
on notice “that they could be denied ECT protection if they fell within
its scope.”\footnote{168} As stated by Jagusch, “[o]ne might fairly expect . . . that
in the light of Article 17, a well-advised investor would seek additional
undertakings and comfort from the host state and would not under-
take capital investments in reliance upon mere speculation as to the
availability of treaty protection.”\footnote{169} This only makes sense. Overseas
investment operations are costly and complex matters, and one would


\footnote{165} \textit{Burlington}, ¶ 100.

\footnote{166} Id.


\footnote{168} Jagusch & Sinclair, \textit{ supra} note 63, at 99; see also Shore, \textit{ supra} note 96, at 64 (explaining the reasonable notice provided by Article 17).

\footnote{169} Jagusch & Sinclair, \textit{ supra} note 63, at 100.
assume that investors would prefer to be certain of their rights from such a transaction's inception. The charge that it is onerous to put the burden on states to investigate the ownership of each inward bound investment is also a legitimate criticism. As asserted by Mistelis and Baltag, "states usually become aware of the circumstances justifying the denial of benefits only when faced with a claim by a presumptive investor." This reality makes it difficult for host States to monitor which foreign investors might fall under the ambit of Article 17(1) and so decide against whom they should exercise it.

However, there are credible counterarguments to these indictments, as the well-reasoned and methodical decisions laid down in Yukos Universal and Plama evidence. Furthermore, these replies gain force with each likeminded tribunal award. Some argue that the mere existence of ECT Article 17(1) serves notice to shell companies that they may be denied standing under the Treaty. However, it can now be said that the inverse is true: that the rulings by the Yukos Universal and Plama Tribunals serve as notice to all ECT signatories that they should make proactive use of Article 17(1) or risk losing its benefit. As such, while ECT signatories may disagree with this interpretation of Article 17, they can no longer claim to be surprised by it. Therefore, if they seek to guarantee their rights under ECT Article 17(1) they should now turn their attention toward exercising the provision in a preventative manner. In accordance with Yukos Universal and Plama, this means exercising Article 17(1) prior to the development of investment dispute rather than after an ECT arbitration claim has been made and doing so in a public manner reasonably available to investors that specifically references the ECT.

If the interpretation of Article 17(1) reached in Yukos Universal and Plama becomes the established standard going forward, then energy firms from non-ECT signatory states interested in expanding into Europe and Asia will have good reason to cheer. However, their approval should be a cautious one. It is true that the Tribunals in these cases were in agreement on several key points. However, it is

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170 Mistelis & Baltag, supra note 114, at 1315; see also Jagusch & Sinclair, supra note 63, at 101.
171 Shore, supra note 96, at 64.
172 Plama Consortium Ltd. v. Republic of Bulgaria, ICSID Case ARB/03/24, Decision on Jurisdiction, 44 I.L.M. 721, 745 (Feb. 8, 2005); see Yukos Universal Ltd. (Isle of Man) v. Russian Federation, ¶ 457 (Perm. Ct. Arb. 2009), available at http://ita.law.uvic.ca/documents/YULvRussianFederation-InterimAward-30Nov2009.pdf. The Plama Tribunal held that such public notice could include an official declaration in the Contracting State's gazette, a statutory provision in the state's investment law, or even "an exchange of letters with a particular investor or class of investors." Plama, 44 I.L.M. at 745. Article 17(1) is silent on how it must be exercised. See Mistelis & Baltag, supra note 113, at 1319.
equally true that their treatment of Article 17(1) was not entirely comprehensive. Several crucial issues associated with Article 17(1) have yet to be investigated in detail and much of the fortunes of shell companies can still turn on these points. In particular, the Tribunals in Yukos Universal and Plama Consortium neglected to determine exactly what constitutes “substantial business activities"\textsuperscript{173} for the purposes of Article 17(1) as well as which party bears the burden of addressing this standard. They also neglected to definitely determine when the Article must be exercised during the life cycle of an investment project and what the effects of such timing may be.

The Yukos Universal Tribunal emphasized that Article 17(1) will be irrelevant where the purported shell company is not “owned" or “controlled" by an investor from a non-ECT state or does in fact have “substantial business activities" in the jurisdiction of its incorporation.\textsuperscript{174} In the case at hand, the Yukos Universal Tribunal identified control in the ownership of a majority of shares through two corporate levels and a further level of seven trusts.\textsuperscript{175} This interpretation is in line with the ECT, which defines control to include “control in fact, determined after an examination of the actual circumstances of each situation."\textsuperscript{176} Nor does it contradict the ruling of the tribunal in Plama which held that ownership included both “indirect and beneficial ownership" and that control includes “control in fact, including an ability to exercise substantial influence over the legal entity’s management, operation and the selection of members of its board of directors or any other managing body."\textsuperscript{177}

These rulings are instructive. They do much to inform what is meant by “control" under the provisions of the ECT and largely compliment related investment arbitration case law.\textsuperscript{178} However, neither the Yukos Universal Tribunal nor the Plama Tribunal turned their attention to the meaning of the term “substantial business activities" as

\textsuperscript{173} ECT, supra note 3, art. 17(1).
\textsuperscript{174} Yukos, ¶ 460.
\textsuperscript{175} Id. ¶¶ 536-537.
\textsuperscript{177} Plama, 44 I.L.M. at 747.
\textsuperscript{178} Related international investment arbitration case law clearly supports the notion that de jure control will satisfy an otherwise undefined control standard under an investment treaty. See D’Allaire, supra note 65, at 56. (citing Int'l Thunderbird Gaming Corp. v. United Mexican States, NAFTA, Award, ¶¶ 101-110 (Jan. 26, 2006); Generation Ukraine, Inc. v. Ukraine, ICSID Case No. ARB/00/9, Final Award, 44 I.L.M. 404 (Sept. 16, 2003)). Related international arbitration case law also generally supports the notion that de facto control will satisfy such an otherwise undefined treaty control requirement. See id. at 56 (citing Vacuum Salt Prod. v. Ghana, ICSID Case No. ARB/92/1, Award, ¶ 43 (Feb. 16, 1994)).
contained in ECT Article 17(1). Nor is the term expressly defined by the ECT. This leaves much to interpretation with little in the way of formal guidance. After all, the “criterion of substantial business presence is subjective.” It seems clear that a shell company would not clear this hurdle, existing as it would only on paper and without engaging in any form of business activity. However, more difficult factual scenarios are not difficult to imagine. For example, what about a company incorporated in the United Kingdom and listed on the FTSE (London’s stock exchange) but with the vast majority of its business operations and staff located in a foreign, non-ECT jurisdiction? Alternatively, what about the case of a satellite subsidiary that is dwarfed by and ultimately acts as the arm of its foreign corporate parent? Furthermore, should the amount of business considered to be “substantial” be decided on absolute or relative terms?

The ECT provides no guidance on these points. Nor does the Treaty expressly address which party should bear the burden of satisfying the substantial business activities standard. Durward Sandifer stated long ago that, as a general rule, “the burden of proof rests upon him who asserts the affirmative of a proposition that if not substantiated will result in a decision adverse to his contention.” This principle suggests that because it is the host state that activates Article 17, the host state also bears the burden of establishing that its requirements are met, including proof that the claimant has no substantial business activities in the jurisdiction of its organization. However, it is unclear whether this formulation is appropriate in the context of ECT Article 17. D’Allaire rightly points out that “[b]ringing evidence to the effect that a given corporation has no substantial business activities is already difficult, but for a state to demonstrate that a private entity has no substantial business activities in a foreign jurisdiction may end up being challenging.” It is difficult enough to evidence a negative contention. It is even more difficult to do so from a distance.

179 It was not necessary to do so in Yukos Universal because Yukos Universal freely admitted that it did not have substantial business activities in the Isle of Man. See Yukos Universal, ¶ 461. Similarly, in Plama, Plama Consortium admitted that it did not have substantial business activities in Cyprus. See Plama, 44 I.L.M. at 732.

180 D’Allaire, supra note 65, at 57.

181 See Mistelis & Baltag, supra note 114, at 1315.


183 D’Allaire, supra note 65, at 57. Related case law is not of much assistance. The issue of burden of proof is not directly addressed by the Tribunal in Yukos Universal. The Tribunal in Plama, on the other hand, sent mixed signals on this point. As noted by D’Allaire, at one point its decision implies that that the party asserting an argument has the burden of proving it. On the other hand, its reasoning also
The finer points regarding the timing and related effects of ECT Article 17(1) have also yet to be determined. Both Russia and Bulgaria purported to exercise their rights under ECT Article 17(1) well after the investments in question had taken place. As such, in both cases the Tribunals held that it would counter the object and purpose of the ECT to allow a subsequent exercise of Article 17 to retroactively dissolve the standing that Claimants were to that point entitled to. However, neither Tribunal considered what the effect of Article 17 would be in slightly more complicated circumstances. In particular, neither Tribunal considered what the effect of a purported exercise of ECT Article 17(1) would be well after an investment’s inception but prior to the institution of an investment arbitration claim. This point begs several questions. First, must Article 17 be exercised prior to the investment being made? What if the Article is exercised during the middle of an investment’s life cycle? Does the exercise of Article 17 at such an intermediary stage effectively cut an investment in half for the purpose of ECT protection so that claims can only be levied in response to acts occurring before the exercise of the Article? Finally, how would such a division affect the calculation of damages in the event of any future award in favour of the Claimant? The answers are not immediately clear.

Once could argue that an exercise of ECT Article 17(1) will be effective so long as it occurs after an investment has been made. This would be a nice, simple, bright line rule capable of easy application with little confusion. However, one could also argue that such an approach would be open to easy manipulation by host states. The Tribunal in *Plama* held that it would be unfair to apply Article 17(1) retroactively because such retroactive application would rob investors of the ability to accurately anticipate and plan for the protection available to their investments. However, the validity of this argument does not necessarily diminish after the investment has been made. As

seems to imply that the other party was also expected to submit evidence on the issue. Other investment arbitration tribunals have looked at the burden issue more closely, albeit in the context of treaties other than the ECT. In *Generation Ukraine, Inc. v. Ukraine*, for example, the tribunal held that the respondent host state seeking to invoke the denial of benefits clause bears the onus of establishing the factual basis of control by a non-signatory party. See *Generation Ukraine*, 44 I.L.M. 404, 433 (2005). In contrast, in *CCL v. Kazakhstan*, the tribunal held that the investor bringing a claim has the burden of providing to the Tribunal “the necessary information and evidence concerning the circumstances of ownership and control, directly and indirectly, over [Claimant-investor] at all relevant times.” *CCL v. Kazakhstan*, SCC Case 122/2001, Jurisdictional Award at 152 (Stockholm Chamber of Commerce, 2003), available at http://ita.law.uvic.ca/documents/CCLvKazakhstan.pdf.

184 *Plama*, 44 I.L.M. at 747.
the Tribunal in *Plama* also recognized, once a foreign direct investment is made, a “hostage factor” takes effect which limits the investor’s choices and renders it “correspondingly more vulnerable to the host state’s exercise of its right under Article 17(1).”\(^\text{185}\) The investor is committed. Its interests are vested and cannot easily be uprooted, and it is at the mercy of the host state’s policies going forward. This means that “the covered investor needs at least the same protection as it enjoyed as a putative investor able to plan its investment.”\(^\text{186}\) To hold otherwise would be to allow ECT host states to entice foreign investment on the premise of ECT protection only to dissolve that protection afterward through the exercise of Article 17(1).

In the alternative, one could argue that an exercise of ECT Article 17(1) after an investment has been made will be effective so long as it occurs prior to the host state action which forms the basis of any related investment arbitration claim.\(^\text{187}\) This approach would extend the investor’s protection under the ECT past its inception and further into its life cycle. This approach would also put the onus on the host state to exercise its Article 17(1) rights well before engaging in any activity which could otherwise be considered a violation of its ECT obligations. However, this approach does not go so far as to totally dispel the concerns of the *Plama* Tribunal canvassed above. In particular, it does not prevent a host state from gaming the system simply by exercising Article 17(1) before engaging in sovereign behaviour otherwise prohibited by the ECT. Illegitimate host state interference with an investment project can take many forms. It may occur in discrete acts that instantly alter the fortunes of an investor and amount to independent violations of investment treaty standards. It may also occur in a series of smaller, interrelated acts which collectively amount to a composite breach of a protective guarantee.\(^\text{188}\) Where the latter is the case, a “breach centered” approach to ECT Article 17(1) is highly problematic. It would effectively condone a campaign of state interference which approaches but does not effectively cross the line between non-abusive and abusive treatment. In the case of creeping or indirect expropriation, for example, this could excuse all initial harmful changes to a host state’s petroleum law prior to that change which finally undermines the economic viability of the project.\(^\text{189}\)

\(^{185}\) *Id.*  
\(^{186}\) *Id.*  
\(^{187}\) Kaj Hober appears to read this to be the implied reasoning of the *Plama Consortium* Tribunal. See Hofer, *supra* note 36, at 351.  
\(^{188}\) See Siemens AG v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, ¶ 264, 271 (Feb. 6, 2007).  
CONCLUSION

The ECT has been on the radar screen of “treaty shoppers” for some time. This is not likely to change any time soon. The Treaty is perhaps the most significant and far-reaching international investment protection treaty yet concluded, particularly where the international energy industry is concerned. It covers a large and diverse set of developed and transitional economies stretching from Western Europe through Central Asia to the Far East. It provides foreign investors organized under the laws of these countries a comprehensive set of protective guaranties designed to deter illegitimate sovereign interference with their business interests. It also provides these investors with a reliable and impartial set of arbitration forums before which to settle any investment disputes that might arise.

The ruling of the Tribunal in Yukos Universal ensures that this affinity will persist for the immediately foreseeable future. First, it affirms previous case law establishing that jurisdictional provisions which require merely that a company is organized according to the laws of a signatory should be given their plain meaning regardless of the consequences. It makes this assertion in regard to ECT Article 1(7) but the ruling builds on and is reinforced by a line of consistent previous decisions related to similar standing provisions in other investment protection treaties. Secondly, it affirms the ruling of the Tribunal in Plama that ECT Article 17(1) must be exercised by a host state prior to the filing of an investment dispute by a disaffected investor. Importantly, this marks the second step in a potentially equally consistent line of case law on the meaning and effect of the ECT’s “denial of benefits” clause. Taken together, these aspects of the Yukos Universal jurisdictional award can only encourage prospective foreign investors from non-ECT signatories to incorporate shell companies in the jurisdiction of ECT signatories in attempt to gain access to the Treaty’s protective provisions.

Of course, as there exists no strict principle of stare decisis in international investment law future shell companies will not be guaranteed the same treatment received by Yukos Universal. Rather, the chance that future tribunals will break from the reasoning adopted by the Yukos Universal Tribunal remains a distinct possibility. Much will depend on the circumstances of the case and on the inclinations of the particular investment tribunal, including the weight they place on relevant investment arbitration precedent. The decision of the tribunal in Yukos Universal v. Russia is authoritative in that it is soundly argued and built on the back of its forebears. However, not all future investment tribunals are certain to acknowledge these qualities. It is

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also important to remember that the decision in *Yukos Universal v. Russia* does not finally answer all questions raised regarding the ability of shell companies to effectively harness the protective provisions of the ECT. In particular, the decision fails to definitively rule on the effect of a purported exercised of Article 17(1) during the middle of a foreign investment’s lifecycle but prior to the eruption or filing of an investment dispute. This is a significant issue which may one day lead to fervent legal debate with billions of dollars of potential damages again hanging in the balance. Furthermore, as no precedent exists on this point, the issue will be for an investment tribunal to decide as a matter of first instance.