Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment

No. 48 October 10, 2011

Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Editor: Ken Davies (kendavies@yahoo.com)
Managing Editor: Alma Zadic (az2242@columbia.edu)

The new Dutch sandwich: The issue of treaty abuse

by
George Kahale, III*

Years ago, international tax lawyers introduced us to the term "Dutch sandwich." The concept was to sandwich a Dutch company between an investor from country A and its investment in country B. The combination of the extensive network of Dutch tax treaties and investor-friendly domestic Dutch tax law meant that country A's investor could reduce withholding tax on dividends out of country B and perhaps eliminate capital gains tax altogether by structuring its investment through a Dutch company.

A different type of Dutch sandwich has emerged over the past fifteen years, this time not related to taxes. It is the product of the extensive network of Dutch bilateral investment treaties (BITs). Companies from all over the world having little if anything to do with The Netherlands seek to acquire Dutch nationality to take advantage of the protections offered by Dutch BITs.

This type of nationality planning has been championed by many in the field of investor-state arbitration, but it is giving BITs a bad name. It does not take much to form a Dutch company. No real offices or employees are necessary, and visiting the country is optional. The benefits sought are not only the substantive treaty protections, but access to ICSID, the forum for dispute settlement specified in most Dutch BITs.

Many states on the receiving end of foreign investment are getting upset at what they see as treaty abuse. They are reexamining treaties they entered into over the past twenty years, often without appreciation of the consequences. There are a number of reasons for this, not the least of

* George Kahale, III (gkahale@curtis.com) is Chairman of Curtis, Mallet-Prevost, Colt & Mosle LLP; he has represented a number of states and state entities in contract negotiations and renegotiations as well as in investment disputes, including Mobil Corp. v. The Bolivarian Republic of Venezuela, referred to herein. The author wishes to thank Alejandro Faya Rodriguez, Matthew Skinner and Felix Alberto Vega Borrego for their helpful comments on this text. **The views expressed by the author of this *Perspective* do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

which is the expansive interpretation given by some tribunals to terms such as "fair and equitable treatment."[1] But the issue of who gets in the door is an obvious source of annoyance to those who never imagined that a treaty with one country could open the gates to potentially a whole world of investors.

The subject of treaty abuse has received heightened attention recently due to a number of cases involving the restructuring, rather than the structuring, of investments. Restructuring can take place for any number of legitimate business reasons, but often it is done simply for the purpose of moving into a treaty jurisdiction and gaining access to ICSID. The effectiveness of restructuring to achieve that goal becomes most questionable when its timing indicates that it was done in anticipation of litigation.[2] The basic issue is whether there are any limits to the ability to restructure into a treaty jurisdiction or, put another way, whether there is such a thing as treaty abuse. Decisions such as *Phoenix Action Ltd. v. Czech Republic*[3] and *Mobil Corp. v. The Bolivarian Republic of Venezuela* indicate that there is.[4]

Although several tribunals prior to *Phoenix* had discussed the circumstances that might constitute treaty abuse, the issue gained momentum with *Phoenix*, where the tribunal dealt with an intra-family transaction apparently intended to shift an investment into a treaty jurisdiction in the midst of a dispute with the host state. The tribunal rejected that maneuver, using strong language to underscore the need to guard against abuse of the ICSID system:

> The Tribunal is concerned here with the international principle of good faith as applied to the international arbitration mechanism of ICSID. The Tribunal has to prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made in compliance with the international principle of good faith and do not attempt to misuse the system are protected. . . . It is the duty of the Tribunal not to protect such an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs. [5]

The *Mobil* tribunal quoted language from *Phoenix* in holding that transfers into a treaty jurisdiction did not confer ICSID jurisdiction over pending disputes.[6]

These decisions have already been the subject of much discussion in the international arbitration community, but there is more to come. Other tribunals will soon have the opportunity to define further the concept of treaty abuse, undoubtedly generating more commentary and controversy

[1] See "Public statement on the international investment regime," August 31, 2010, available at: www.osgoode.yorku.ca.

[2] See Zachary Douglas, *The International Law of Investment Claims* (Cambridge: Cambridge University Press, 2009), at 551.

[3] Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, *award* (April 15, 2009).

[4] Mobil Corporation and others v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, *decision on jurisdiction* (June 10, 2010).

[5] Phoenix Action Ltd. v. Czech Republic, op. cit., at 113 and 144 (internal citation omitted).

[6] Mobil Corporation and others v. Bolivarian Republic of Venezuela, op. cit., at 205.

on what has become a hot issue in investor-state arbitration. In the future, the issue of treaty abuse may be addressed in the terms of new BITs (assuming that BITs continue to proliferate), but in the meantime tribunals will have to work out for themselves the limits of restructuring into treaty jurisdictions. Merely satisfying the technical requirements of nationality at the time of filing a request for arbitration does not suffice under the *Phoenix* and *Mobil* formulations, and it should not.

For further information please contact: Vale Columbia Center on Sustainable International Investment, Jennifer Reimer, FDIPerspectives@gmail.com.

The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

Most recent *Columbia FDI Perspectives*

- No. 47, Manfred Schekulin, "Shaping global business conduct: The 2011 update of the OECD Guidelines for Multinational Enterprises," September 26, 2011.
- No. 46, Geraldine McAllister and Joel H. Moser, "Beyond treasuries: A foreign direct investment program for U.S. infrastructure," September 12, 2011.
- No. 45, Sjoerd Beugelsdijk, Jean-François Hennart, Arjen Slangen, and Roger Smeets, "FDI stocks are a biased measure of foreign affiliate activity," August 29, 2011.
- No. 44, Kathryn Gordon and Joachim Pohl, "Environmental concerns in international investment agreements: The 'new era' has commenced, but harmonization remains far off," August 15, 2011.
- No. 43, Hermann Ferré and Kabir Duggal, "The world economic crisis as a changed circumstance," August 1, 2011.
- No. 42, Persephone Economou and Karl P. Sauvant, "From the FDI Triad to multiple FDI poles?," July 18, 2011.
- No. 41, Gert Bruche, "Emerging challengers in knowledge-based industries? The case of Indian pharmaceutical multinationals," July 1, 2011.
- No. 40, Ken Davies, "Why and how least developed countries can receive more FDI to meet their development goals," June 20, 2011.
- No. 39, Terutomo Ozawa, "The role of multinationals in sparking industrialization: From 'infant industry protection' to 'FDI-led industrial take-off'," June 6, 2011.
- No. 38, Nicolás Marcelo Perrone, "Responsible agricultural investment: Is there a significant role for the law to promote sustainability?," May 23, 2011.

All previous *FDI Perspectives* are available at http://www.vcc.columbia.edu/content/fdi-perspectives.