

Denial of Benefits: When, How, and With What Effect?

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DEFINITION AND EXAMPLES

- DoB: clause whereby the State reserves the right to deny the benefits of a treaty to a company that has **no economic connection** to the state on whose nationality it relies.
- Examples:
 - Energy Charter Treaty, Art. 17(1)
 - US-Ukraine BIT, Art. I(2)

DEFINITION AND EXAMPLES

- **Energy Charter Treaty, Art. 17(1)**

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; [...]

DEFINITION AND EXAMPLES

- **US-Ukraine BIT, Art. I(2)**

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

PURPOSE OF THE D_oB CLAUSE

- Excluding from treaty protection so-called **“mailbox”** or **“shell companies”** and, with them, **“free-riders”**.
- **Maintaining reciprocity** with regard to treaty benefits, by counterbalancing the effect of **broad treaty definitions of “investors.”**

EFFECT OF THE DoB CLAUSE

- **No jurisdiction:** Ulysseas v Ecuador, Pac Rim v El Salvador, Rurelec v Bolivia.
- The benefits “of this Treaty” or “of this Chapter” (of CAFTA) include the dispute resolution provisions.
- **Inadmissibility:** Generation Ukraine v Ukraine. Similar treaty language.
- DoB is “a potential filter on the admissibility of claims”.

EFFECT OF THE DoB CLAUSE

- **Merits issue:** Plama v Bulgaria; Yukos cases.
- ECT: the DoB clause refers to the advantages of “this Part”, ie Part III of the ECT which deals with the **substantive obligations of investment protection**.
- The dispute resolution clause is in a different part of the ECT – Part V.
- Issue dealt with at jurisdiction/admissibility stage.

WHEN TO INVOKE THE DoB CLAUSE

- Treaties are often silent
- What is at stake?
- The right to deny treaty benefits **must be exercised**: it does not operate automatically.
- However, tribunals diverge as to **when and how this right can and should be exercised**.
- **Prospective or retrospective** effect?
- **Time limit** for invocation of DoB clause?

PROSPECTIVE EFFECT AND NOTICE BEFORE INVESTMENT OR DISPUTE

ECT Tribunals:

- Notice of denial only has **prospective effect**.
- Notice should be given **before the investment is made** (Plama) or **before the dispute arises** (Ascom v Kazakhstan).

PROSPECTIVE EFFECT AND NOTICE BEFORE INVESTMENT OR DISPUTE

Arguments in support of prospective effect:

- No conclusive indications in Art. 17(1)
- Reliance on the ECT's **object and purpose** as stated in its Art. 2:

“This Treaty establishes a legal framework in order 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.” (Plama, Yukos, Liman v Kazakhstan)

PROSPECTIVE EFFECT AND NOTICE BEFORE INVESTMENT OR DISPUTE

Further arguments in support of prospective effect:

- Retrospective application would run counter to the investor's **legitimate expectations**.
- Retrospective application would also be contrary to the **principle of legal certainty**.
- “**Hostage factor**” if retrospective effect.
- Prospective application allows for **proper investment planning**.

PROSPECTIVE EFFECT AND NOTICE BEFORE INVESTMENT OR DISPUTE

Therefore, the investor needs to be given notice:

- **before making any investment (Plama); or**
- **before the dispute arises (Ascom).**

Art. 17 of the ECT is “**at best half a notice**”
(Plama).

RETROSPECTIVE EFFECT AND NOTICE WITH JURISDICTIONAL OBJECTIONS

BIT and CAFTA tribunals:

- Notice of denial may have **retrospective effect**.
- Notice should be given **no later than in the statement of defense (UNCITRAL) or no later than the deadline for the filing of the counter-memorial (ICSID)**.

RETROSPECTIVE EFFECT AND NOTICE WITH JURISDICTIONAL OBJECTIONS

Arguments in support of retrospective effect:

- Consent to arbitration is “**conditional**” or “**qualified**” from the outset by the DoB clause. (Rurelec, Pac Rim)
- The investors are **aware of the possibility** for the State to exercise its right of denial **from the time they made their investments**. (Ulysseas, Rurelec)
- The investors’ **legitimate expectations** are not frustrated. They may be in a “**fragile position**”, but the BIT is “**not a secret.**” (Rurelec)
- Ruling out retrospective effect would run counter to the **purpose** of the DoB clause. (Rurelec)

RETROSPECTIVE EFFECT AND NOTICE WITH JURISDICTIONAL OBJECTIONS

Arguments in support of notice with jurisdictional objections:

- No limit in treaty text (Rurelec)
- In the absence of a dispute, investigations by the State may be seen as a **“groundless and hostile act contrary to the promotion of investments”**. (Rurelec)
- If earlier time limit, **real practical difficulties for the host States**: monitoring the ever-changing business activities of companies and their corporate structures; requiring business confidential information. (Pac Rim)

HOW: FORM OF NOTICE

If notice is **prospective**:

- a general declaration in a Contracting State's official gazette; or
- a statutory provision in a Contracting State's investment or other laws; or
- an exchange of letters with the investors (Plama)

If notice is **retrospective**:

- A statement in the counter-memorial or the statement of defense (Ulysseas, Pac Rim, Rurelec)

WAY FORWARD?

Consensus on the need to exercise the right of denial.

Divergence as to when it should be exercised and what the effects are.

- Should tribunals revisit the meaning and scope of “benefits”/“advantages”?
- Should treaty language be amended? Should states opt for automaticity? (the benefits of the treaty “shall be denied”)?

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