Kluwer Arbitration Blog

KT Asia v Kazakhstan: Should the Owners of Offshore Corporate Groups Be Afraid?

Dmytro A. Shemelin (Ilyashev & Partners) · Friday, November 29th, 2013

The “contribution of assets” requirement of the Salini test was often overlooked by commentators and tribunals, probably due to its “I-know-it-when-I-see-it” nature. The recent award in KT Asia Investment Group B.V. v Republic of Kazakhstan, however, demonstrates that a failure to meet the contribution requirement may put to rest a claim of an offshore company used to conceal the identity of its owner.

It is widely recognized that under Article 25 of the ICSID Convention an investment must involve a “contribution” of assets. As explained by Douglas (para. 273), the prior contribution of assets into the economy of the host state is a natural *quid pro quo* for the state to accord the special regime of protection to the investor’s assets and to consent to the investment arbitration. The modern understanding of the contribution as a “commitment of resources” may be illustrated, e.g. by the Deutsche Bank award (paras. 298-300).

An ordinary BIT definition of investment, to the contrary, demands only that a covered investment be “owned or controlled” by the investor. In Malicorp (para. 110) the tribunal attempted to provide a reconciliation between the BIT and the ICSID Convention, stating that the “contribution” and the “ownership or control” requirements are “in reality complimentary”, so that “assets cannot be protected unless they result from contributions, and contributions will not be protected unless they have actually produced the assets”.

Nonetheless, the asset which is now “owned or controlled” by an investor was not necessarily “contributed” by the same investor earlier. Imagine a Chilean investor purchases the shares of a Bolivian enterprise (there is a BIT between Bolivia and Chile). Normally, after the purchase, the shares will be an “asset owned or controlled”. As regards the “contribution” requirement, however, there is a whole range of possibilities.

If the shares are bought directly from the Bolivian issuer, this is a classical contribution into the Bolivian economy. If the same shares are bought from a Bolivian shareholder, the payment going to Bolivia will still be a “contribution”, but it is not a protected contribution, since the investor has no title to it. If the shares are bought from a Panamian shareholder, the payment will go outside Bolivia and there will be no Bolivian contribution at all. The situations may be even more complicated: what if the shares are bought from a Bolivian shareholder, but the payment is made to its Panamian account? Clearly, in the most part of these situations Bolivia will not receive any *quid pro quo* for its undertakings under the BIT.

One of the above situations existed in Quiborax v Bolivia, where Quiborax (Chile) claimed that its shares in NMM (Bolivia) are investments. Quiborax, however, paid for the shares, at least partially, to a Panamian corporation (Quiborax, 159), and therefore apparently made no "contribution" in Bolivia.

The tribunal concluded that since "the object of the payment and *raison d'être* of the transaction – the mining concessions – were located in Bolivia," the payment satisfies the contribution requirement (Quiborax, 229). However, the tribunal denied jurisdiction to another claimant in the Quiborax case – Mr. Fosk, who obtained a share in NMM, but made no payment for it (Quiborax, 233).

Quiborax suggests that the tribunal treated the payment made abroad as a "contribution" in Bolivian territory, since its intended economic effect was in Bolivia. The alternative understanding – that Quiborax was permitted to rely on the initial contribution to NMM capital, does not fit, since Mr. Fosk should have benefitted from that contribution as well.

The tribunal faced a similar problem in the recent award of KT Asia v Kazakhstan.

Mr. Ablyazov, a Kazakh national, acting via a number of foreign intermediaries, unofficially owned and controlled up to 76% interest in BTA Bank (Kazakhstan). He never disclosed his aggregate beneficial ownership to the Kazakh authorities and all the shareholders under his effective control acted as if independent.

The Claimant was a shell company set up to hold a portion of Mr. Ablyazov's shares in BTA Bank for their further private placement with third party investors (KT Asia, 19). In 2007 the Claimant purchased 9.96% interest in the BTA Bank from Torland and Refgen, also beneficially owned by Mr. Ablyazov.

No payment for the shares was made; instead, the Claimant took a loan from Torland and Refgen, to be repaid from the proceeds of the sale. The sale never happened; the loan was, accordingly, never repaid; Torland and Refgen were later dissolved by Mr. Ablyazov's decision.

When in 2009 the Kazakh Government removed control from the Bank's shareholders (KT Asia, 34), the Claimant referred to ICSID.

It was clear that since the Claimant never paid for the shares, there was no "direct" contribution in Kazakhstan territory, and neither there was a "Quiborax-type" indirect contribution. Therefore, although the Claimant owned and controlled the investment under the BIT, it should have followed the fate of Mr. Fosk and be denied jurisdiction.

The Claimant, however, argued that since the purchase of shares by KT Asia was a corporate restructuring within the group controlled by Mr. Ablyazov, the absence of payment was normal and did not preclude jurisdiction. Effectively, the Claimant seems to have invoked its corporate identity with the person who made the initial contribution when purchasing the shares in BTA Bank. Logically, if the Claimant and the initial contributor form part of the same corporate group and could be treated as the same person, this would absolve the Claimant from the necessity to make an independent contribution. This would also distinguish the Claimant's case from other cases, where a purely nominal payment for the investment put the existence of contribution to doubt (Phoenix, Saba Fakes, Caratube).

The tribunal provisionally accepted that a new contribution is not required when the investment is transferred from one group affiliate to another. The question was therefore whether there was a corporate group for the jurisdictional purposes (KT Asia, 194). This is where the reasoning of the tribunal becomes somewhat vague.

In para. 195 of the Award, the tribunal set the general definition of a corporate group for jurisdictional purposes. The tribunal asserted that a group of companies "exists when two or more corporations are under common ownership or control", and where such group generally operates "as a single economic entity with a common objective and strategy and a group management".

At first blush it appears that the group of entities controlled by Mr. Ablyazov and including the Claimant fits into this definition. First, despite there is no single shareholder connecting all the companies of the group in a formal way, it was not disputed that Mr. Ablyazov in fact controls all the entities in his group. Second, the tribunal established that Mr. Ablyazov treats the assets of the group "as his personal property" (Award, 205), and therefore in addition to the unity in terms of control there is also certain economic unity.

The fatal problem with this approach was, however, that Mr. Ablyazov's group was created precisely to conceal that there is unity in terms of control and economics. Before the present case, Mr. Ablyazov repeatedly stated that the shareholders of BTA Bank (which in reality formed part of his "group") are not under his control. There was no official unity of the group in terms of tax or financial reporting. It is only during the proceedings before the tribunal that the composition of the group came to light. It would be somehow illogical, therefore, if Mr. Ablyazov could benefit from the existence of the group after having repeatedly denied such existence.

The tribunal did not engage the estoppel concept, but it could have argued that after Mr. Ablyazov officially claimed to the Kazakh authorities and the foreign creditors of the BTA Bank that there is no corporate group structure, he is now estopped from claiming that all his entities form a corporate group.

The *KT Asia* case may have the following implications.

First, the award restates the contribution requirement of the Salini test. The contribution may be direct or indirect (Quiborax-type) but an absent or a nominal contribution may cause a denial of jurisdiction.

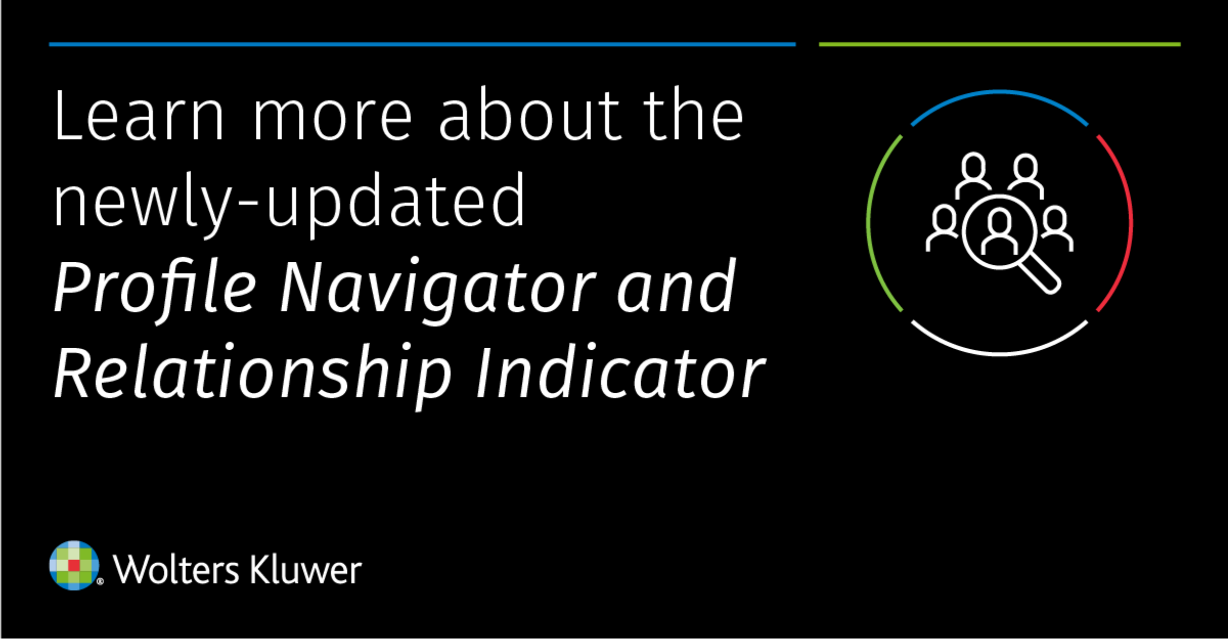
Second, the contribution is probably not required where the investment is transferred from one member of a corporate group to another, since the new owner may rely upon the contribution made by its associate. A corporate group for this purpose is a set of entities under common ownership or control, which generally operates as a single economic entity with a common objective and strategy and a group management.

Third, the existence of the group must be evident before the commencement of the dispute. If the group owner uses the corporate structures to conceal his/her ownership of the investment or altogether denies that the corporate group exists, he/she cannot rely on the existence of such group for the purposes of the second point above.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.



This entry was posted on Friday, November 29th, 2013 at 6:30 am and is filed under Arbitration, ICSID Convention, Investment, Investment Arbitration, Investment protection, Investor
You can follow any responses to this entry through the Comments (RSS) feed. You can skip to the end and leave a response. Pinging is currently not allowed.