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The invocation of “denial of benefits clauses”: when and how?

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In an award rendered on 31 January 2014, an arbitral tribunal constituted under the UNCITRAL Rules declined jurisdiction over the claims brought by one of two claimants against the Plurinational State of Bolivia on the basis of the application of a denial of benefits clause in the US-Bolivia BIT.[1)]

The two claimants were Rurelec Plc, a company constituted under the laws of England & Wales, and its affiliate Guaracachi América Inc. (**GAI**), a company incorporated in the United States. The dispute concerned the alleged violation by Bolivia of certain provisions of the US-Bolivia BIT and the UK-Bolivia BIT (the **BIT**).

Among the various jurisdictional objections raised in the proceedings, Bolivia argued in its Statement of Defense that the tribunal lacked jurisdiction over the claims of GAI pursuant to Article XII of the BIT, which provides in its relevant parts that:

“*Each party reserves the right to deny to a company of the other Party the benefits of this Treaty if nationals of a third country own or control the company and […] (b) the company has no substantial business activities in the territory of the Party under whose laws it is constituted or organized*“.

Bolivia contended that it was entitled to deny the benefits of the BIT (i.e. consent to arbitration) to GAI since the conditions for the application of Article XII were satisfied: GAI was controlled by nationals of a third State and had no substantial business activities in the territory of the United States. It should be noted that the investment claimed by GAI was made prior to the entry into force of the BIT.

GAI’s main argument in response to Bolivia’s objection was that the denial of benefits clause of Article XII cannot operate retroactively since the objective of this provision is to allow a Contracting Party to notify investors in advance that they have been denied the benefits granted in the BIT, thereby protecting their legitimate expectations.

After first deciding that the requirements of Article XII had been met, the tribunal went on to determine whether Bolivia had invoked the right to deny the benefits of the BIT in a timely manner. In other words, the tribunal had to decide whether Article XII has retroactice effect.

The tribunal began its analysis by acknowledging that Bolivia had denied the benefits afforded in the BIT in the Statement of Defence after both parties had consented to arbitration. Nevertheless, the tribunal noted that "*[w]henever a BIT includes a denial of benefits clause, the consent by the host State to arbitration itself is conditional and thus may be denied by it, provided that some objective requirements concerning the investor are fulfilled*".[2)]

The tribunal considered that any US investor claiming under the US-Bolivia BIT, such as GAI, should be aware of the existence of the denial of benefits clause and its potential invocation by host State if the requirements contained therein are satisfied. When accepting the offer by the host State to arbitrate, investors simultaneously accept the risk envisaged in Article XII, hence no legitimate expectations are affected by the denial of benefits.

The tribunal further highlighted that the investment in that case was made prior to the BIT's entry into force, hence *"[t]he benefits contained in the BIT […] did not play any role in the decision of the investor to make this investment*".[3)]

As to the retroactive application of Article XII, the tribunal rejected GAI's argument and held that "*[the] very purpose of the denial of benefits is to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits*".[4)] It is for this reason that, according to the tribunal, "*it is proper that the denial is "activated" when the benefits are being claimed*".[5)] In this regard, the tribunal reasoned that the right to deny the benefits of the BIT can be invoked at the time the objections to jurisdiction are raised, and need not be "notified" separately before such time.

The tribunal therefore considered that Bolivia's invocation of Article XII was made in a timely manner in accordance with Article 23(1) of the UNCITRAL Rules, and held that it had no jurisdiction to hear GAI's claims against Bolivia.

The conclusion that may be drawn from this decision is that denial of benefits clauses become effective at the time such benefits are sought by the investor, that is, after the host State has consented to arbitration. As such, if the treaty in question is silent as to the timeline for the invocation of a denial of benefit clause, there is no obligation for the host State to deny the benefits of the treaty before the request for arbitration is filed.

The position adopted in *Rulelec & GAI v. Bolivia* reflects the reasoning of the ICSID tribunal in *Pac Rim Cayman LLC c. El Salvador*.[6)] In that case, the tribunal was faced with the question of whether El Salvador could, pursuant to Article 10.12.2 of the US-Central America Free Trade Agreement (**CAFTA**), deny its consent to ICSID arbitration after the dispute has arisesn.

Article 10.12.2 of CAFTA, which contains a similar wording to that of Article XII of the US-Bolivia BIT, stipulates that:

"*[a] Party may deny the benefits of this Chapter [which contains the offer of the State to arbitrate] to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise*".

The tribunal noted that "*[t]here is no express time-limit in CAFTA for the election by a CAFTA Party to deny benefits under CAFTA Article 10.12.2*".[7] Therefore, the denial of benefits clause in CAFTA can be invoked retroactively up to the limit for presenting jurisdictional objections pursuant to ICSID Arbitration Rule 41 (i.e. no later than the expiration of the time limit fixed for the filing of the counter-memorial).

After finding that the conditions set forth in Article 10.12.2 were satisfied, the tribunal declared that it lacked jurisdiction over the claims brought by *Pac Rim Cayman* under CAFTA.

It is worth stressing that both tribunals agreed that, unless otherwise provided in the treaty, the States were entitled to deny the benefits afforded in the respective treaties after such benefits are claimed by the investor.

Despite the consistency of the decisions in *Rulelec* and *Pac Rim Cayman*, other tribunals hearing claims under the Energy Charter Treaty (**ECT**) have adopted a different approach regarding the invocation of denial of benefits clauses.

The landmark decision in this context was issued in the ICSID case of *Plama Consortium Ltd. v. Bulgaria*.[8] In this arbitration, Bulgaria exercised its right under Article 17(1) to deny the benefits of the ECT to the claimant a few months after the filing of the request of arbitration. The tribunal had to determine whether the exercise of this right should have retrospective effect, as argued by Bulgaria, or, to the contrary, it operates prospectively only.

Article 17 (1) of the ECT provides that:

"*Each Contracting Party reserves the right to deny the advantages of this Part [III] 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*".

The tribunal found that, in accordance with the object and purpose of the ECT, the host State must give notice and expressly exercise its right under Article 17(1), and such right will only have prospective effect. The tribunal noted that Article 17(1) requires that the host State "properly" notify the investor in advance of the potential effects of this provision. Therefore, and contrary to position adopted in *Rulelec* and *Pac Rim Cayman*, the denial should be invoked before the benefits are being claimed by the investor.

In the words of the tribunal: "*[i]f […] the right's exercise had retrospective effect, the consequences for the investor would be serious. The investor could not plan in the "long term" for such an effect (if at all); and indeed such an unexercised right could lure putative investors with legitimate expectations only to have those expectations made retrospectively false at a much later date*".[9] Furthermore, "*[g]iven that in practice an investor must distinguish between Contracting States with different state practices, it is not unreasonable or impractical to interpret Article 17(1) as requiring that a Contracting State must exercise its right before applying it to an investor and be seen to have done so*".[10]

In addition to determining the prospective effect of the exercise of the right to the deny benefits under the ECT, the tribunal held that Article 17(1) does not affect the jurisdiction of the tribunal but the merits of the case. This is because, according to the tribunal, Part III of the ECT only refers

to substantive investment protection benefits and not to the offer of the State to arbitrate.

The decision of the *Plama* tribunal has been followed by other ECT tribunals deciding on the application of Article 17(1).[11)]

The decisions described above highlight a diverging jurisprudence as to how and when denial of benefits clauses should be invoked by respondent States. Although each of the aforementioned treaties has been concluded between different parties and in distinct contexts, the provisions contained therein are not so dissimilar. The question remains whether future tribunals will follow the approach adopted by the tribunals in *Rulelec* and *Pac Rim Cayman* or by the growing line of ECT case law considering the denial of benefits right under Article 17(1).

References

?1 *Guaracachi America, Inc. (U.S.A.) and 2. Rurelec plc (United Kingdom) v. Plurinational State of Bolivia*, UNCITRAL, Award, 31 January 2014

?2 *Id*, parr. 372

?3 *Id*, parr. 380

?4 *Id*, parr. 376

?5 *Id*

?6 *Pac Rim Cayman LLC v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Award on Jurisdiction, 1 June 2012

?7 *Id*, parr. 4.83

?8 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award on Jurisdiction, 8 February 2005

?9 *Id*, parr. 162

?10 *Id*, parr. 157

?11 See eg: *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227, UNCITRAL, Award on Jurisdiction, 30 November 2009; *Liman Caspian Oil B.V. (the Netherlands) and NCL Dutch Investment B.V. (the Netherlands) v. Republic of Kazakhstan*, ICSID Case No. ARB/07/14, Award, 22 June 2010

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