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**Research Report**

## The new Dutch sandwich: The issue of treaty abuse

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## **Columbia FDI Perspectives**

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### **The new Dutch sandwich: The issue of treaty abuse**

by

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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

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which is the expansive interpretation given by some tribunals to terms such as “fair and equitable treatment.”<sup>1</sup> 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.<sup>2</sup> 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*<sup>3</sup> and *Mobil Corp. v. The Bolivarian Republic of Venezuela* indicate that there is.<sup>4</sup>

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.<sup>5</sup>

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

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

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<sup>1</sup> See “Public statement on the international investment regime,” August 31, 2010, available at: [www.osgoode.yorku.ca](http://www.osgoode.yorku.ca).

<sup>2</sup> See Zachary Douglas, *The International Law of Investment Claims* (Cambridge: Cambridge University Press, 2009), at 551.

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

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

<sup>5</sup> *Phoenix Action Ltd. v. Czech Republic*, op. cit., at 113 and 144 (internal citation omitted).

<sup>6</sup> *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.

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