New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 253—NO. 28
WEDNESDAY, FEBRUARY 11, 2015

Outside Counsel

Expert Analysis

Abusive Reorganization of Investments To Obtain International Treaty Benefits

By **Elliot E. Polebaum**

And **Helene Gogadze**

It is perfectly legitimate for an investor to seek to protect itself from the general risk of future disputes with a state in which it invests, and to do so by structuring the investment in a way that the investor considers beneficial. For example, an investor may transfer assets from one entity to another, or establish a new entity in a jurisdiction that is considered protective of the investor's interests. The benefits of corporate restructuring may include the availability of substantive protections and guarantees under an investment treaty, and the possibility to arbitrate an investment dispute with the state where the investment is made before the International Centre for Settlement of Investment Disputes (ICSID).

Recently, in *Levy and Gremcitel v. Republic of Peru*, an international arbitration tribunal recognized that "an organization or reorganization of a corporate structure designed to obtain investment treaty benefits is not illegitimate per se, including where this is done with a view to shielding the investment from possible future disputes with the host state."[1] However, corporate reorganizations that change the nationality of an investor to manufacture ICSID jurisdiction can be problematic. Whereas a local investor cannot invoke investment treaty protections under bilateral and multilateral investment treaties, a foreign investor may be able to do so. Therefore, when a corporate reorganization transforms a local company into a foreign company to try to enable an investor to invoke investment treaty protections and to initiate international arbitration against the host state, the respondent state is likely to call foul and raise jurisdictional objections.

That is what happened in *Levy*. In this case, Renée Rose Levy, a French national, and Gremcitel S.A., a Peruvian company, initiated ICSID arbitration against the Government of Peru. On Jan. 9, 2015, the ICSID Tribunal issued an award, finding that the corporate restructuring by which Levy became the main shareholder of Gremcitel and sought to confer on Gremcitel the French nationality necessary to initiate investment treaty arbitration under the France-Peru Bilateral Investment Treaty (BIT) constituted an abuse of process. The tribunal concluded that the only purpose of the restructuring was to obtain access to ICSID arbitration, which would have otherwise been precluded because Gremcitel is a Peruvian company. In particular, the restructuring was carried out on the eve of arbitration, at a time when the claimants could very well foresee the impending dispute with the Government of Peru.

The tribunal also ruled that the finding of abuse of process justified an award of costs against the unsuccessful claimants. The tribunal ordered the claimants to pay the government's share of the arbitration costs, as well as a portion of the government's legal fees and expenses, amounting to an award of approximately US $1.6 million.

The tribunal's award in *Levy* is a reminder that manipulating corporate restructuring to manufacture ICSID jurisdiction may amount to an abuse of process. Further, the tribunal's award confirms that the finding of abuse of process would not only result in a dismissal of the investor's arbitration claims, but may also lead to a substantial award of costs and legal fees against the investor.

Levy Case

In 2011, Levy, a French national, and Gremcitel, a Peruvian company, initiated ICSID arbitration against the Government of Peru. The claimants argued that Peru breached the France-Peru BIT. Specifically, they asserted that the government failed to accord fair and equitable treatment as a result of Resolution 1342, issued by Peru's National Institute of Culture, which blocked Gremcitel's development of an oceanfront property

ELLIOT E. POLEBAUM *is a partner at Fried, Frank, Harris, Shriver & Jacobson; he is chair of the firm's Washington, D.C., litigation department.* HELENE GOGADZE *is a litigation associate resident in the firm's D.C. office.*

in Lima. Claimants sought US $41 billion in damages.[2]

To assert a treaty violation under the France-Peru BIT before an ICSID tribunal, the claimants had to demonstrate that Gremcitel, even though a Peruvian entity, had to be treated as a French company because of its control by a French national.[3] Without such a showing Gremcitel could not invoke the protections of the BIT by initiating ICSID arbitration against Peru.

To demonstrate Gremcitel's French nationality, Levy maintained that, at the time when the dispute arose, she controlled Gremcitel. Specifically, Levy asserted first that she had acquired an indirect ownership in Gremcitel in 2005, when she obtained 33.3 percent of the capital of Hart Industries, a Grenadian company that owned 84.5 percent of the shares of Gremcitel. Levy further asserted that, in October 2007, she acquired from Hart Industries 58.82 percent of its shares in Gremcitel.[4] In sum, Levy contended that she was the controlling shareholder of Gremcitel in October 2007 when Resolution 1342 was issued.

Peru challenged the accuracy and reliability of the corporate documents that Levy submitted as evidence to show her indirect and direct ownership of shares in Gremcitel. In addition, Peru contended that Levy had acquired her interest when the dispute between Gremcitel and Peru had already arisen in order to bring the dispute within the scope of the BIT. Peru submitted that Levy hurriedly acquired her interest in Gremcitel when the government had taken or was about to take key actions that would affect Gremcitel. Peru argued that Levy had acquired control of the company for the sole purpose of internationalizing an otherwise domestic dispute.[5]

The tribunal concluded that Levy had established her control of Gremcitel in 2007 before the dispute arose, but refused to exercise jurisdiction on the basis that Levy's acquisition of shares in Gremcitel was abusive.

Specifically, the tribunal found that a sudden transfer of shares to Levy on the eve of the adoption of Resolution 1342 was made for the sole purpose of transforming a domestic dispute into an international investor-state dispute. The tribunal concluded that at the time Levy acquired her shares in Gremcitel, the dispute was a very high probability, not just a mere possibility. In particular, the tribunal found that the event giving rise to the dispute occurred on Oct. 18, 2007 when Resolution 1342 was published.

> The tribunal's award in 'Levy' is a reminder that manipulating corporate restructuring to manufacture ICSID jurisdiction may amount to an abuse of process.

The transfer of the shares to Levy occurred on Oct. 9, 2007, only one day before Resolution 1342 was issued, and nine days before it was published. The tribunal considered that such a striking proximity of events was not a coincidence. The claimants could foresee that the resolution delimiting the land use was forthcoming. Levy learned the government was about to formalize the land delimitation, and the transfer of the shares was then quickly set in motion. The fact that the transfer of shares was perfected only one day before the decision to delimit land use left no doubt for the tribunal that the change in Gremcitel's ownership and Resolution 1342 were correlated. The tribunal also pointed out that the claimants were unable to provide any reasonable business rationale for the 2005 or the 2007 transfer of Hart Industries shares to Levy. Hence, the tribunal concluded that the only reason for the sudden transfer of the majority shares was to take advantage of Levy's nationality.[6]

In addition, the tribunal was troubled by many inconsistencies in the documents that Levy proffered to prove her acquisition of the shares. The tribunal considered these documents unreliable and reproached the claimants for attempting to establish jurisdiction by way of documents that were untrustworthy, if not utterly misleading. Particularly damning was the hearing testimony of claimant's expert, who was also the notary public who certified the signatures appearing on the corporate resolutions effecting transfer of the shares to Levy in 2005. At the hearing, the expert testified that she backdated the notarization in 2010 and again in 2012, both times at the request of Levy's brother. The tribunal noted that a pattern of manipulative conduct cast a bad light on the claimants' actions.[7]

In sum, the tribunal agreed with the Government of Peru that Levy was inserted into Gremcitel's ownership structure for no purpose other than to obtain BIT protection due to her French nationality, and that this was done at a time when the dispute with the Government of Peru had already arisen or was at least foreseeable. A restructuring of the investment in these circumstances amounted to abuse of process.

The tribunal also ruled that claimants' abuse of process justified an award of costs against them. The tribunal ordered claimants to pay the government's share of the costs of the proceedings, and in addition, approximately US $1.5 million of the government's legal fees.[8]

Doctrine in Other Cases

In *Phoenix Action v. The Czech Republic*, a tribunal found that an investor abused the ICSID arbitration system because the sole purpose of investments in two local Czech companies was to be able to pursue an ICSID claim on behalf of

these companies, without any intent to perform any economic activity in the host country.[9] The tribunal noted that the timing of the investment was the first factor to be considered. The foreign investor had invested in local companies after the government had already taken alleged adverse actions against these companies.

The tribunal concluded that the whole operation was not a bona fide economic investment, but a legal fiction—simply a rearrangement of assets within a family, to gain access to ICSID jurisdiction to which the initial investor was not entitled. As in *Levy and Gremcitel v. Republic of Peru*, the Phoenix tribunal ordered the claimant to pay the state's share of the arbitration costs, as well as its legal fees and expenses.[10]

However, in *Tidewater et al. v. Bolivarian Republic of Venezuela*, a tribunal reached a different result.[11] In that case, Venezuela alleged that Tidewater restructured its business by incorporating Tidewater Barbados and placing Tidewater's local Venezuelan business under its ownership in order to gain access to ICSID arbitration under the Barbados-Venezuela BIT. The respondent also alleged that the restructuring was carried out after the dispute was foreseeable.

The tribunal noted that at least one of the reasons for the restructuring was to protect claimants against the risk of nationalization. However, the tribunal noted that the relevant inquiry was whether there was "a reasonable prospect" that "such a nationalization was imminent" at the time when the restructuring was consummated or completed. The tribunal found that the acts of expropriation that gave rise to the dispute were not reasonably foreseeable at the time Tidewater undertook the restructuring. Therefore, there was no abuse of process.[12]

Threshold for Finding

The threshold for finding abuse of process is high. Allegations of abuse of process based on an investor's reorganization of an investment can succeed only in exceptional circumstances. Whether a corporate restructuring amounts to abuse of process depends on the specific circumstances of the case. In that regard, arbitration tribunals have considered the timing of the restructuring to be a critical factor. The closer in time the restructuring is to the actions that give rise to the investment dispute, the greater the likelihood that the tribunal will scrutinize the investor's bone fides. If a restructuring is carried out at a time when a dispute with the state is imminent in order to enable the investor to invoke an investment treaty's protections and obtain ICSID jurisdiction, the tribunal is likely to find an abuse of process.

The tribunal in *Pac Rim Cayman v. Republic of El Salvador* explained that a key determining factor is whether an investor "can see an actual dispute or can foresee a specific future dispute as a very high probability and not merely as a possible controversy."[13] Thus, corporate restructurings before this time is reached should ordinarily not be considered an abuse of process, but thereafter investors proceed at their peril. In both *Levy* and *Phoenix Action*, the restructuring took place after this point in time, whereas in *Tidewater* the tribunal found that the restructuring was completed before materialization of the dispute[14] Still, arbitration tribunals will be evaluating each case based on its specific circumstances. In addition to the timing of the restructuring, tribunals have also considered other factors, such as whether the restructuring was made in good faith, and whether there are legitimate business reasons for the restructuring. Because tribunals consider all the circumstances, there will necessarily be uncertainty so that the investors should proceed cautiously.[15]

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1. *Levy and Gremcitel v. Republic of Peru*, ICSID Case No. ARB/11/17, Award (Jan. 9, 2015), ¶184. ICSID has been instrumental in the development of investment treaty arbitration. Many investment treaties contain the contracting states' consent to arbitrate before the ICSID Centre any investment disputes arising from the treaty. While an investor may also have an option to bring an investment treaty dispute before another arbitration forum, generally speaking, when ICSID jurisdiction can be established, investors prefer ICSID arbitration. This preference is mainly due to the fact that ICSID awards, unlike other international arbitration awards, may not be subject to judicial review and annulment in the courts of any jurisdiction, and hence, benefit from a more favorable enforcement regime than awards rendered outside the ICSID Convention framework. Further, ICSID is a special forum created to address specifically disputes arising from the investment relationship between a private investor and a host state.
2. ¶¶65-66.
3. Generally, an investor has to demonstrate that the parties to the dispute had agreed to treat a local company under a foreign control as a foreign company for purposes of ICSID jurisdiction. However, here, such agreement was already provided in the France-Peru BIT. ¶162.
4. ¶¶89-91.
5. ¶¶93-100, 174-176.
6. ¶¶187-191; 152-155.
7. ¶¶154, 194, 195.
8. ¶¶198-202.
9. *Phoenix Action v. The Czech Republic*, ICSID Case No. ARB/06/5, Award (April 15, 2009), ¶144.
10. ¶¶136, 140, 152.
11. *Tidewater v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Decision on Jurisdiction (Feb. 8, 2003).
12. ¶¶56-65, 194, 197-198.
13. *Pac Rim Cayman v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on the Respondent's Jurisdictional Objections (June 1, 2012), ¶2.99.
14. See also *Lao Holdings v. The Lao People's Democratic Republic*, ICSID Case No. ARB(AF)/12/6, Decision on Jurisdiction (Feb. 21, 2014), ¶76 (focusing on "a moment when things have started to deteriorate so that a dispute is highly probable").
15. *Aguas del Tunari v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction (Oct. 21, 2005), ¶330 ("[I]t is not uncommon in practice and—absent a particular limitation—not illegal to locate one's operation in a jurisdiction perceived to provide a beneficial regulatory and legal environment"); *Pac Rim Cayman*, ¶2.47 ("[I]f a corporate restructuring affecting a claimant's nationality was made in good faith before the occurrence of any event or measure giving rise to a later dispute, that restructuring should not be considered as an abuse of process."); *Tidewater*, ¶184 ("[I]t is a perfectly legitimate goal, and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host state").