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ARTICLES

YUKOS, INVESTMENT ROUND-TRIPPING, AND THE EVOLVING PUBLIC/ PRIVATE PARADIGMS

*Delphine Nougayrède**

I. INTRODUCTION

The combined $50 billion awards[1] that were issued by the Yukos investment tribunal against the Russian Federation in July 2014 have already given rise to a considerable amount of commentary[2] – and more will no doubt be forthcoming.

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* Delphine Nougayrède is an adjunct lecturer at Columbia Law School. From 2006 to 2013 she headed DLA Piper's corporate practice in Russia and the CIS. The author is grateful to Anthea Roberts for her comments on an earlier draft. This article reflects the personal views of the author only and not those of DLA Piper or any of her colleagues; all errors are her own.

[1] There were three separate awards, all formulated in quasi-identical terms: Hulley Enterprises Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 226, Final Award; Yukos Universal Limited (Isle of Man) v. The Russian Federation, PCA Case No. AA 227, Final Award and Veteran Petroleum Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 228, Final Award, all dated July 18, 2014. These July 2014 awards were preceded by jurisdictional awards in 2009: Hulley Enterprises Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 226, Interim Award on Jurisdiction and Admissibility; Yukos Universal Limited (Isle of Man) v. The Russian Federation, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility and Veteran Petroleum Limited (Cyprus) v. The Russian Federation, PCA Case No. AA 228, Interim Award on Jurisdiction and Admissibility, all dated November 30, 2009. *See* http://www.pca-cpa.org/showpage.asp?pag_id=1599. There were two more investment tribunal decisions rendered in the *Yukos* case, one under the United Kingdom-USSR treaty (Rosinvest Co. UK Ltd. v. The Russian Federation, SCC No. 079/2005 (Sept. 2010), *available at* http://www.italaw.com/sites/default/files/case-documents/ita0720.pdf) and one under the Spain-USSR bilateral investment treaty (Renta 4 S.V.S.A, Ahorro Corporación Emergentes F.I., Ahorro Corporación Eurofondo F.I., Rovime Inversiones SICAV S.A., Quasar de Valors SICAV S.A., Orgor de Valores SICAV S.A., GBI 9000 SICAV S.A. v. The Russian Federation, SCC No. 24/2007 (July 20, 2012), *available at* http://www.italaw. com/cases/documents/1510#sthash.I5JkqbIN.dpuf). These awards are not addressed in this article, however, as the claimants were legal entities for which there was no indication of ultimate beneficial ownership or control by Russian nationals, i.e., they did not involve domestic investment round-tripping structures.

[2] Much of the commentary on the awards tends to be supportive of the views of the tribunal. *See, e.g.*, Paul Blyschak, *Yukos Universal v. Russia: Shell Companies and Treaty Shopping in International Energy Disputes*, 10 RICH. J. GLOBAL L. & BUS. 179 (2011); Paul B. Stephan, *International investment law and municipal law: substitutes or complements?*, 9 CAP. MARKETS L.J. 354 (2014); Ruth Teitelbaum, *What's Tax Got to Do With It? The Yukos Tribunal's Approach to Motive and Treaty Interpretation,* TRANSNAT'L DISP. MGMT. (Dec. 2014); Andrew Newcombe, *Yukos Universal Limited*

For its part, this article takes a critical look at the treatment by the investment tribunal of the multi-layered cross-border corporate structuring that was implemented by the Yukos shareholders outside of Russia. Beyond its use of Russian trading companies to minimize its Russian taxes, the Yukos group was a sophisticated example of investment round-tripping[3] by domestic investors, through the use of holding companies and trusts registered in Cyprus, the Isle of Man, Jersey, Gibraltar, the British Virgin Islands ("BVI") and Guernsey. The paradox of course is that such vehicles are now increasingly viewed as susceptible to misuse and therefore targeted in a number of transparency initiatives, most notably under the auspices of the Financial Action Task Force ("FATF"), Organization for Economic Co-operation and Development ("OECD") and European Union ("EU"). Important policy reproaches are made to investment round-tripping, notably that it enables tax and regulatory avoidance and that through the use of secretive corporate vehicles it facilitates the laundering of proceeds of criminal activities such as corruption. Such views eminently reflect

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(Isle of Man) v. The Russian Federation: An Introduction to the Agora, 30 ICSID REV. 283 (2015); Tarcisio Gazzini, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: Provisional Application of the ECT in the Yukos Case,* 30 ICSID REV. 293 (2015); Christopher S. Gibson, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: A Classic Case of Indirect Expropriation*, 30 ICSID REV. 303 (2015); Aloysius Llamzon, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: The State of the 'Unclean Hands' Doctrine in International Investment Law: Yukos as both Omega and Alpha*, 30 ICSID REV. 315 (2015); Irmgard Marboe, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: Calculation of Damages in the Yukos Award: Highlighting the Valuation Date, Contributory Fault and Interest*, 30 ICSID REV. 326 (2015); Julien Fouret & Pierre Daureu, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: Enforcement of the Yukos Awards: A Second Noga Saga or a New Sedelmayer Fight?*, 30 ICSID REV. 336 (2015); Eric de Brabandere, *Yukos Universal Limited (Isle of Man) v. The Russian Federation: Complementarity or Conflict? Contrasting the Yukos Case before the European Court of Human Rights and Investment Tribunals*, 30 ICSID REV. 345 (2015). A few commentators have ventured more critical views, however. Some are critical of the tribunal's approach to contributory fault. *See* Wojciech Sadowski, *Yukos and Contributory Fault,* TRANSNAT'L DISP. MGMT., Oct. 2014 (more on his views below). Others have expressed concern (in my view correctly) with the tribunal's references to *ex ante* political motivation which seem to pervade the awards and underpin many of its conclusions. *See* Sophie Nappert, *Mammoth Arbitrations: The Yukos Awards of 18 July 2014,* TRANSNAT'L DISP. MGMT., Oct. 2014. For a Russian (fairly neutral) reaction, see Ilya Rashkov, Бывшие акционеры "ЮКОСа" против России. Комментарий к арбитражному решению под эгидой Постоянной Палаты Третейского Суда в Гааге // Международное правосудие. 2014. N 3. С. 18 - 34 [*Former shareholders of Yukos versus Russia, Commentary on the arbitral award of the Permanent Court of Arbitration at the Hague*, INTERNATIONAL JUSTICE, Nr. 3, 2014, p. 18-34], available on the *KonsultantPlus* legal data base.

[3] Investment round-tripping is the process whereby investors (usually from emerging countries) invest into their own economy not through domestic legal entities, but through foreign holding companies registered in specialized jurisdictions. See below the beginning of Part II.

public law concerns, where the aim is to protect collective welfare, regulate business activity and facilitate the work of law enforcement. But seen from a *private law* angle, however, round-tripping appears to be more acceptable, because it seeks to achieve other objectives that are considered legitimate in the global order – it enables investors from emerging markets to exercise their party autonomy and access more sophisticated legal orders, and it enables them to claim international property rights protection perceived to be stronger than property rights protection under their domestic laws.

Investment round-tripping is therefore at the crossroads of two opposite legal paradigms in the global order. At one end of the spectrum, the fight against tax and regulatory avoidance is joined together with the global fight on corruption and money laundering through policy efforts that are informed by a public law paradigm privileging economic substance over legal form, a paradigm in which law enforcement bodies and courts are able to look through the legal form of structures in order to rectify their outcomes. At the other end of the spectrum is the prevailing paradigm of *party autonomy* in transnational commercial and company law, a domain in which the paramount principle is to respect the will of the parties and uphold their expectations to the maximum extent possible.

International investment law, although treaty-based and arguably an offshoot of public international law,[4] approaches corporate nationality at the jurisdictional stage according to the private law paradigm, preferring legal form over economic substance and respecting to the maximum extent possible the legal structures that are selected by investors. In reviewing its own jurisdiction to hear the dispute under the Energy Charter Treaty ("ECT") the *Yukos* tribunal did not question the corporate structuring that had been implemented by the Yukos shareholders, and found that it had jurisdiction on the basis of a literal interpretation of the treaty. In doing so it followed previous awards, and indeed the argument can be made that ultimately this jurisdictional interpretation served a wider welfare purpose; but at the same time, the European Court of Human Rights in Strasbourg had no need of multi-layered cross-border corporate structuring to reach its own finding that the Russian government has breached international law.[5] And while the *Yukos* tribunal

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[4] There has been voluminous scholarship examining the hybrid nature of international investment law and the conflicting paradigms that coexist within it. *See*, *e.g.*, Zachary Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 BRIT. Y.B. INT'L L. 151 (2003), Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 107 AM. J. INT'L L. 45 (2013); Stephan Schill, *The Sixth Path: Reforming Investment Law from Within,* Fourth Biennial Global Conference of the Society of International Economic Law (SIEL) Working Paper No. 2014/02), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446918; Caroline Forster, *A New Stratosphere? Investment Treaty Arbitration as "Internationalized Public Law",* 64 INT'L & COMP. L. Q. 461 (2015).

[5] OAO Neftyanaya Kompaniya Yukos v. Russia, ECtHR Case No. 14902/04 (Sept. 29, 2011). For an analysis of the differences between the investment tribunals' approach and the ECtHR approach to the *Yukos* case, see Stephan, *supra* note 2, and de Brandabere, *supra* note 2.

privileged the private law paradigm to establish its jurisdiction and the admissibility of the claim under the ECT, it then switched to a public law approach at the moment of assessing the damages owed by the Russian government – at that point it decided that the Yukos group had been over-aggressive in its tax planning and would be penalized through a significant reduction of the damages award.

This article does not aim to conduct a full analysis of corporate nationality under the existing law of investment arbitration. Rather, it uses the *Yukos* awards to illustrate contradictory approaches to transnational corporate structuring in different fields of law that are contiguous yet ultimately fall on opposite sides of the public/private divide. From the standpoint of its policy effects, the private law approach to corporate nationality illustrated by these awards encourages the use of round-tripping structures in developing and emerging markets, and therefore seems at cross purposes with global initiatives in favor of transparency and against corruption, money laundering and tax avoidance. The *Yukos* awards also raise the question of consistency of evolving paradigms in discrete fields of law. Global transparency initiatives are gradually changing the perception of what constitutes acceptable transnational corporate structuring; the question, however, is whether these evolutions are capable of also extending to investment arbitration under existing investment treaties. If the answer is yes, then future investment tribunals may have to engage more critically with some of the cross-border corporate constructions that they are asked to review.

II. A SUMMARY OF INVESTMENT ROUND-TRIPPING AND ITS OBJECTIVES

Investment round-tripping is the process whereby investors that are resident in a certain country route their investments into their own economy not directly, i.e. through domestic legal entities, but through intermediary foreign companies that are interposed between them and the target of the investment. A semantic ordering exercise may be useful at this point – the intermediary companies that are used in these cases are sometimes referred to (derogatorily) as "shell" companies,[6] "mailbox" companies,[7] "sham" companies,[8] "shelf" or "conduit" companies,[9] or

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[6] Blyschak, *supra* note 2. The FATF defines "shell companies" as "companies that are incorporated [and] that have no significant operations or related assets" (FATF Guidance, *Transparency and Beneficial Ownership*, Oct. 2014, http://www.fatf-gafi.org/media/fatf/styleassets/ images/Guidance-beneficial-ownership-transparencyl.pdf).

[7] EU Commission, *Concept Paper, Investment in TTIP and Beyond – The Path for Reform*, May 2015, at 2, *available at* http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF.

[8] Jeffrey Zients, *Investor-State Dispute Settlement (ISDS) Questions and Answers*, THE WHITE HOUSE BLOG (Feb. 26, 2015), *available at* https://www.whitehouse.gov/blog/2015/02/26/investor-state-dispute-settlement-isds-questions-and-answers.

(more neutrally) as "holding companies," "corporate vehicles," or "special purpose entities."[10] There is no accepted single definition of these different categories. One ICSID tribunal attempted to draw a distinction between "traditional holding companies" which "will usually have a board of directors, board minutes, a continuous physical presence and a bank account," from "shell companies," which "normally" have "no geographic location for [their] nominal, passive, limited and insubstantial activities."[11] In that case the tribunal concluded that the company under examination, a Cayman Islands LLC, fell into the second category. However, even a Cayman Islands company must have at least one director who issues minutes or decisions and sits in an office,[12] so it is unclear where the line between these categories must be drawn. In this article, I will use the neutral expression of "holding company," reflecting the fact that the main activity of these companies is to hold shares in other companies.

Investment round-tripping is used to achieve a number of objectives.[13] Tax minimization must probably be mentioned first. Round-tripping can enable domestic investors to claim domestic tax incentives that are reserved for foreign investors, when such incentives exist. When the holding company is incorporated in a specialized jurisdiction[14] (as is normally the case), these domestic tax benefits are obtained without incurring any additional tax cost linked to the

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[9] The expression is apparently used by the Chinese tax regulator (State Administration of Taxation, or SAT) when determining whether foreign holding companies can claim tax treaty benefits. *See* Guoshuihan [2009] No. 601, Oct. 27, 2009, *cited by* Dirk Dewitte, Finsen Chan, Yves Knel, & Jim Chung, *The Use of Various Jurisdictions for Investment in China*, TAX NOTES INT'L (Aug. 30, 2010).

[10] The designation of "special purpose entity" ("SPE") is the one favored by international bodies. *See* OECD, BENCHMARK DEFINITION OF FOREIGN INVESTMENT (4th ed. 2008) ("BMD4"), and *How Multinational Enterprises Channel Investments Through Multiple Countries*, Feb. 2015. *See also* UNCTAD, *World Investment Report 2014*, Box I.1 on treatment of "transit FDI," at 3.

[11] Pac Rim Cayman LLC v. Republic of El Salvador, ICSID Case No. ARB/09/12, Decision on the Respondent's Jurisdictional Objections (June 1, 2012), ¶¶ 4.72 and 4.75.

[12] In some cases the director itself is a corporation, but this just displaces the presence of the physical individual up one level along the corporate rungs.

[13] On round-tripping, its objectives and the difficulties that it generates for statistical data reporting on foreign investment flows, see OECD, BMD4, *supra* note 10, ¶¶ 467-471.

[14] By specialized jurisdiction I mean a jurisdiction in which company law and corporate services are structured as a specific commercial offering, often for foreign users. This will usually involve: (i) the presence of professional corporate and trust services providers that are willing to provide legal addresses and nominee directors for an annual fee; (ii) the absence of any obligation to maintain any meaningful local substance or actual headquarters; and (iii) a low taxation regime especially when companies conduct most of their business outside of the territory. Specialized jurisdictions often allow the practice of wide corporate indemnities in favor of directors, which can even be included in the articles of the companies, and they impose fiduciary obligations on directors that are often less onerous than in many "onshore" jurisdictions, including during the "twilight" period when companies are nearing insolvency.

existence of the holding company and therefore represent a net gain. Round-tripping can lower exit costs from investments, when an investee company is ultimately sold at a profit, capital gains realized by holding companies in specialized jurisdictions upon sales of investee shares usually being exempt from taxation (this is referred to in international tax practice as "participation exemption"). More negatively, round-tripping can enable the exploitation of tax incentives in favor of exports, through trade mispricing and return of the funds in the form of FDI.[15]

A second objective of round-tripping is avoidance of various sorts of domestic administrative restrictions, for example in jurisdictions that still apply currency controls or limit the ability of residents to hold assets in foreign currency. Round-tripping in such cases enables the holding of funds abroad and their repatriation as foreign capital when needed.

A third reason, when the investors are in a jurisdiction with insufficiently mature legal institutions, including company law, contract laws and courts, is to allow them to access legal systems that are more developed, for example to implement corporate or contractual arrangements that would not be possible under domestic laws, or to access dispute resolution in reputable foreign venues. This has been a frequent occurrence in Russia and China.[16]

And finally, the fourth objective of round-tripping, in countries with high levels of political risk, is that it enables domestic investors to claim property right protections under international investment law. The *Yukos* awards of $50 billion to two Cyprus holding companies and one Isle of Man company ultimately set up at the behest of Russian beneficiaries is a powerful illustration of the benefits flowing from this kind of structure. If the Russian owners had held their shares in OAO Yukos directly or through Russian legal entities, no protection would have been forthcoming under the ECT.[17] So, to summarize, the main objectives of round-tripping are (1) tax and regulatory optimization or avoidance; (2) access to more sophisticated legal systems; and (3) international property rights protection.

There are no conclusive statistical measures on the importance of investment round-tripping around the world, to this author's knowledge, for most FDI

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[15] This has been examined in the particular case of China. *See* Hung-Gay Fung, Jot Yau & Gaiyan Zhang, *Reported Trade Figure Discrepancy, Regulatory Arbitrage, and Round Tripping: Evidence from the China-Hong Kong Trade Data*, 42 J. INT'L BUS. STUD. 152 (2011); Dev Kar & Sarah Freitas, *Illicit Financial Flows from China and the Role of Trade Misinvoicing*, Global Financial Integrity (Oct. 2012).

[16] Regarding Russia, see Delphine Nougayrède, *Outsourcing Law in Post-Soviet Russia*, 6 J. EURASIAN L. 383 (2013). Regarding China, see Wei Shen, *China's Dilemna: How Can a Weak Company Law Regime Support a Strong Market for International Private Equity Investments? A Real "Piggybacking" Case*, 11 BUS. L. INT'L 195 (2010).

[17] As pointed out above, international law protection was nevertheless forthcoming under the European Convention on Human Rights, and would have been for any other Russian company having suffered treatment contrary to the Convention at the hands of the Russian government.

statistics do not keep track of it.[18] Indirect measures seem to show that it is significant, however, in Russia, China and India for example. One indirect measure is to look at capital outflows on the exit side, and for the re-entry side, the amount of FDI by investors registered in specialized jurisdictions. Capital outflows from all three of these countries have been significant for many years, with a sizable portion of the flows characterized as "illicit" by some commentators.[19] For the period 2000-2014, the largest sources of FDI inflows into India were Mauritius (35%) and Singapore (12%),[20] both countries with tax treaties and specialized corporate laws, therefore offering privileged platforms for investment round-tripping. The figures are even more striking for the PRC: in 2012 and 2013, more than 60% of FDI inflows into the PRC came from Hong-Kong, with Singapore and the BVI representing approximately 6% each.[21] As regards Russia, Cyprus is by far the largest destination of outbound FDI, representing approximately 34% of total recorded stocks, and Cyprus is in return the first foreign investor into the Russian economy.[22] Some of this FDI into China, India and Russia through specialized jurisdictions such as Hong-Kong, Mauritius and Cyprus is surely "genuine" foreign investment, i.e. investment by third-country investors who choose to route their investment through these jurisdictions, but at present there is no way of knowing the split between third-country foreign investors and round-tripping domestic investors.

III. POLICY VIEWS ON ROUND-TRIPPING

Before looking at the treatment of the round-tripping structure in the *Yukos* awards, this part proposes an overview of the evolving policy views regarding the

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[18] The OECD has recently started to track in-bound investments into holding company structures not destined to stay in the country, as reported by countries on a voluntary basis following the implementation of BMD4. *See* BMD4 and *supra* note 10. The IMF also encourages compilers of country data to report round-tripping FDI separately (in countries where it is significant). *See* Int'l Monetary Fund, *Coordinated Direct Investment Survey Guide* (2015), ¶ III.20 at 79, *available at* http://data.imf.org/CDIS. UNCTAD does not itself track round-tripping FDI, as it relies on statistics that are produced nationally. However, it encourages countries to separately track SPE investment. *See World Investment Report 2014*, *supra* note 10.

[19] For the period 2001-2010, Global Financial Integrity has assessed cumulative illicit capital outflows from China, Russia and India at $2,742 billion, $152 billion and $123 billion respectively. *See* Dev Kar & Sarah Freitas, *Illicit Financial Flows from Developing Countries 2001-2010,* at 16, Global Financial Integrity (Dec. 2012).

[20] Indian Department of Industrial Policy and Promotion, *available at* http://www.dipp.nic.in/ English/Publications/FDI_Statistics/FDI_Statistics.aspx.

[21] Nat'l Bureau of Statistics of the People's Republic of China, Statistical Y.B. 2014 (2014), *available at* http://www.stats.gov.cn.

[22] The Russian Central Bank (CBR) reports that as of Dec. 31, 2013 inward FDI stocks into Russia from Cyprus were $183 billion, i.e. 39% of the total $472 billion, and outbound FDI stocks from Russia to Cyprus were $161 billion i.e. 34% of the total $479 billion, http://www.cbr.ru/eng/statistics.

phenomenon of investment round-tripping. It will show that these views are divided and primarily depend on the nature of the objectives that are sought by round-tripping investors. Overall, however, this article makes the argument that global policy views are now increasingly turning to the negative and moving *against* investment round-tripping.

A. *Tax and Regulatory Avoidance*

The two first objectives outlined above, i.e. tax avoidance and regulatory avoidance, are now almost universally viewed as harmful, so round-tripping to achieve them is being increasingly discouraged, both domestically and in global initiatives. Different types of policy measures can be deployed to this effect.

a) One classic measure used by domestic laws to fight against round-tripping is to place *ex ante* administrative controls on outbound capital transfers by domestic residents, i.e. at the point of exit, for example when funds are transferred for the acquisition of shares in a foreign holding company or for the funding of the company. The PRC has a long history of regulating the use of foreign offshore structures through such capital controls at the point of exit.[23] Administrative controls can also be placed at the point of re-entry, in the form of approvals for acquisitions of domestic shares by foreign companies. Such foreign investment controls have existed for many years in India, in various sectors of the economy,[24] and have been used to block round-tripping investments in recent years.[25]

b) Yet another technique that can be implemented domestically is to tax residents on income received by foreign holding companies that are under their ownership or control, when these companies benefit from low tax regimes, through "controlled foreign corporation" ("CFC") taxation mechanisms that look through the layers of intermediary companies in order to impute income directly into the hands of the ultimate beneficiaries at the top. This technique has been used for many years by an increasing number of countries and has recently been endorsed by the G20.[26] CFC rules do not target round-tripping specifically, as they

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[23] Circulars 11, 29 and 75 in 2005, Circular 106 in 2007. *See* Wei Shen, *supra* note 16, at 217. Circular 37 was then published in 2014. *See* H. John Kao et al., *SAFE's New Circular 37 Enhances and Facilitates Round-Trip Investment Registration in PRC,* Sept. 2014, *available at* http://www.jonesday.com/SAFEs-New-Circular-37-Enhances-and-Facilitates-Round-Trip-Investment-Registration-in-PRC-09-05-2014/?RSS=true.

[24] *See Consolidated FDI Policy Circular of 2014*, Department of Industrial Policy & Promotion, *available at* http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf.

[25] *End Round-Tripping, Tackling the Controversial Mauritius Route*, BUSINESS STANDARD, July 18, 2013, *available at* http://www.business-standard.com/article/opinion/end-round-tripping-113071801058_1.html.

[26] CFC rules exist in all or most OECD countries. They now also exist in all of the BRICS, http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-guide-to-cfc-regimes-210214.pdf; http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--India-releases-revised-Direct-Taxes-Code-2013. CFC rules are one of the main planks of the OECD/G20 initiative against Base Erosion and Profit Shifting (or

impute income routed through holding companies regardless of the location of investee companies, but they effectively capture income from domestic investee companies owned through round-tripping structures. CFC rules typically reflect a "look-through" approach that disregards the legal existence of the intermediary holding companies in low tax jurisdictions. CFC rules have existed in the PRC and India for some years.[27] They have just been introduced in Russia.[28]

c) A further technique to control round-tripping is through international tax law and the use of double-tax treaties (as will be shown in the last part of this article, this is particularly relevant to the *Yukos* case). The ability to claim the protection of tax treaties has always been premised on the condition that the recipient of income was not only a resident of one of the contracting states, but also the "beneficial owner" of the income. In recent years the OECD has spearheaded a more substantive definition of "beneficial ownership" for the purpose of these treaty provisions.[29] In layman's terms, this reflects the idea that holding companies that do not have any enough local substance should no longer be able to claim exemptions or reduced withholding tax rates on dividends, royalties or interest that are paid to them by investee companies in "onshore" host economies.[30] It is true that there is resistance to such changes, especially in some

"BEPS"). See the OECD website for the reports on this initiative, which were finalized on Oct. 5, 2015. They include a "2015 Final Report on Action 3" called "Designing Effective Controlled Foreign Company Rules."

[27] CFC rules were introduced in 2008 in the PRC, http://www.asiataxwatch.com/controlled-foreign-corporation-rules-in-china and in 2010 in India, http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--India-releases-revised-Direct-Taxes-Code-2013.

[28] *See* Ruslan Vasutin, *New Russian De-Offshoring Rules – Impact on Foreign Investors and Russian Businesses*, https://www.dlapiper.com/~/media/Files/Insights/Publications/2015/01/New_Russian_deoffshoring_rules.pdf.

[29] The OECD model tax treaty is the mostly widely used model in international tax practice. The other model is the U.N. model – traditionally considered more protective of the interests of capital importing countries. At present it is the OECD that is leading the charge on the redefinition of legitimate tax treaty use in the international order. *See supra* note 26 on the BEPS initative. On beneficial ownership, see OECD, *Model Tax Convention: Revised Proposals Concerning the Meaning of "Beneficial Owner" in Articles 10, 11 And 12*, 19 October 2012 to 15 December 2012 (http://www.oecd.org/ctp/treaties/Beneficialownership.pdf), adopted as part of the *2014 Update to the OECD Model Tax Convention*, 15 July 2014 (http://www.oecd.org/ctp/treaties/2014-update-model-tax-concention.pdf). *See also* Koichiro Yoshimura, *Clarifying the Meaning of "Beneficial Owner" in Tax Treaties*, Tax Analysts Special Report, Nov. 25, 2013, 761, http://taxprof.typepad.com/files/72ti0761.pdf.

[30] Measures to increase foreign substance of the foreign holding companies can also be deployed at the domestic level, as a prior condition to claiming beneficial ownership and tax treaty benefits. Here, too, the PRC provides an example. See, for example, "*Guishuihan*" No. 601 [Domestic Circular] (promulgated by the China State Administration of Taxation, Oct. 27, 2009), examined by Dirk Dewitte et al., *supra* note 9, at 686. Controls are also applied in the PRC in connection with sales of shares of PRC companies performed through foreign holding companies – if the foreign holding company has insufficient non-tax business justification, the sale will be considered

of the specialized jurisdictions. Some of these jurisdictions will continue to issue "tax residency" certificates to holding companies without asking any questions and despite the absence of any local substance. But these new principles increase the ability for source countries to challenge the application of reduced outbound withholding taxes, or even to claim full taxation rights on the activities of the holding company by using the argument that the company is effectively managed on their territory or has a permanent establishment there.[31]

The point here is that international tax law, which was already more substance-oriented than private law, is becoming even more so; the emphasis is placed on where activities are physically located and where management decisions are actually being made, and who makes them, rather than formal governance arrangements set out in corporate documents. This means that it may no longer be sufficient for professional nominee directors located in specialized jurisdictions to rubberstamp board minutes that were drafted by beneficial owners who do not appear anywhere in the paperwork. In order to justify that they exercise actual management control over the entity, they may have to start effectively spending time and applying their minds to the business of the company and its foreign subsidiaries, in turn increasing the cost of administering these intermediary holding companies, potentially in a very significant way. This may in turn raise other difficulties for the users of these structures: it is one thing to sign off your business and assets to a professional nominee who unquestioningly acts on your instructions without any second-guessing; it is quite another to have to deal with an independent-minded fiduciary who, although located in a foreign country and different time zone, begins asking pointed questions on the actual running of the business.

The requirement for real substance in foreign holding companies reflects an increasing policy determination not to allow empty corporate structures unconditional access to tax treaty benefits. The gradual adoption of such standards at a global level under the impetus of the large economies signals an evolution in paradigms and that the public law paradigm is gaining ground.

d) Significant global initiatives are under way in the fight against money-laundering, including of proceeds from corruption and tax evasion, which could also be transformational. These initiatives do not focus on "round-tripping" per se,

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performed in the PRC and taxed accordingly, and there have been examples of enforcement of these standards in recent years. *See* Morrison Foerster Client Alert, *Managing Offshore Holding Companies from China: Recent Case May Suggest Increased Tax Risk,* Oct. 28, 2013, *available at* http://media.mofo.com/files/Uploads/Images/131028-Managing-Offshore-Holding-Companies-from-China.pdf.

[31] The OECD/G20 BEPS initiative, *supra* note 26, proposes additional sets of measures to fight against the abuse of tax treaties. *See Preventing the Use of Treaty Benefits in Inappropriate Circumstances, Action 6: 2015 Final Report*, *available at* http://www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm and *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7: 2015 Final Report, available at* http://www.oecd.org/tax/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm.

but rather aim to create new transparency requirements that will reduce what is referred to as the transnational "misuse" of corporate vehicles,[32] thereby assisting in the identification and policing of round-tripping. These initiatives place requirements not only on banks but also on the other "gatekeepers" of the global financial system, i.e. the lawyers, accountants and providers of corporate or trust services who tend to be actively involved in the implementation of round-tripping structures.[33] The philosophy underlying these measures is fundamentally substance-over-form oriented. It gives limited credit to the legal form of structures and requires gatekeeper professionals to delve behind the paperwork and examine the reality of what is happening before their eyes. In one of its recent publications the FATF describe the process as follows:

> An essential element of the FATF definition of beneficial owner is that it extends beyond legal ownership and control to consider the notion of ultimate (actual) ownership and control. In other words, the FATF definition focuses on the natural (not legal) persons who actually own and take advantage of capital or assets of the legal person; as well as on those who really exert effective control over it (whether or not they occupy formal positions within that legal person), rather than just the (natural or legal) persons who are legally (on paper) entitled to do so.[34]

The FATF initiatives are admittedly all "soft law" (as are the OECD/G20 tax initiatives). Moreover, the FATF has "only" 36 member states. Its 2003

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[32] FATF, *The Misuse of Corporate Vehicles, Including Trusts And Company Service Providers*, Feb. 1, 2012, *available at* http://www.fatf-gafi.org/topics/methodsandtrends/documents/themisuseofcorporatevehiclesincludingtrustandcompanyserviceproviders.html.

[33] The "gatekeeper" initiative bringing lawyers and other professionals into the designated sector for anti-money-laundering purposes began in October 1999, when a Ministerial Meeting of the G8 decided to "consider putting certain responsibilities, as appropriate, on those professionals, such as lawyers, accountants, company formation agents, auditors, and other financial intermediaries who can either block or facilitate the entry of organized crime money into the financial system" (Communiqué of the Ministerial Conference of the G-8 Countries on Combating Transnational Organized Crime, Moscow, Oct. 19-20, 1999, ¶ 7). In 2001, binding gatekeeper provisions were included in the Second EU money laundering directive, *inter alia* creating the obligation to report on certain types of suspicious transactions. In 2003, similar provisions appeared in the revised 40 Recommendations set out by the FATF. At present the latest expressions of the gatekeeper initiative appear as Recommendations 22 and 23 of the International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF Recommendations of Feb. 2012 [hereinafter the FATF Recommendations, 2012], *available at* http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf. For a U.S.-centric account of the gatekeeper initiative, see Kevin Sheperd, *Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transactional Lawyers,* 43 REAL PROP. TR. & EST. L.J. 607 (2009).

[34] FATF, *Transparency and Beneficial Ownership*, October 2014, *available at* http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf.

recommendations, however, were endorsed by 180 countries.[35] Gatekeeper standards were adopted throughout the European Union as early as 2001 when it adopted the Second Money Laundering Directive.[36] Implementing legislation was progressively rolled out in each of the Member States, requiring lawyers, amongst other designated professionals, to identify beneficial ownership of clients *before* providing any real estate, corporate or financial transactional services to them. These tasks all require looking beyond legal form. The UK Money Laundering Regulations 2007, for example, indicate that for bodies corporate, the beneficial owner is any individual who ultimately owns more than 25% of the shares or voting rights, "or otherwise exercises control over the management of the body." This requires "reasonable and proportionate enquiries" by solicitors based on the documentation but also the factual circumstances that appear to them.[37] On top of these requirements that apply in the EU since the Second and Third Money Laundering Directives, the Fourth Money Laundering Directive now includes the creation of mandatory registers that will identify the ultimate beneficial ownership of companies.[38] Certain EU countries have even decided that these registers would be made entirely public.[39]

None of these regulations directly target round-tripping or render it unlawful. However, they are reflective of the increasing policy emphasis on the *reality* of ownership and control within legal structures, *beyond* the formal documentation. With the gatekeeper rules, substance-over-form analysis has reached the very heart of the professional practice of those who are frequently entrusted with the creation and administration of round-tripping structures.

B. *Access to More Sophisticated Legal Systems*

The third objective of round-tripping identified above was access to sophisticated legal systems, mainly in the areas of company law, contracts and dispute resolution. The prevailing paradigm in private international law, which deals with the international recognition of companies and contracts, is that of *party autonomy*, i.e. the will of the parties must be respected and given effect. The

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[35] FATF Recommendations 2012, *supra* note 33, at 7.

[36] Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering, 2001 O.J. (L 344). *See* in particular Recitals 15-18 and 20.

[37] Law Society of England & Wales, *Anti-Money Laundering Practice Note*, ¶ 4.7.4 (2013), recommending that solicitors "monitor situations . . . where control structures appear to be bypassed and make further enquiries at that time."

[38] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May, 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council amd Commission Directive 2006/70/EC. *See* Recital 14 and Article 30.

[39] *See, e.g.*, the UK Small Business, Enterprise and Employment Act 2015.

vast majority of legal systems now accord virtually unconditional recognition to companies registered in foreign jurisdictions; in accordance with the now dominant "incorporation theory," the legal existence of a company is primarily a function of its place of incorporation, not that of its real seat.[40] The dominance of the incorporation theory in the international legal order is the projection, on a transnational scale, of the *domestic* power of legal personality. Under most advanced domestic company laws, the threshold for "piercing the corporate veil" is now very high. The principal policy reason that is put forward for keeping the threshold high is predictability and the need to protect the expectations of the parties (in this case the shareholders), over and above the protections that might be afforded to creditors of the company, both willing and involuntary, or its other stakeholders.

It was not always so, however, and even in the field of company law dominant paradigms can change. Take the example of English company law. The current judicial doctrine on the piercing of the corporate veil was recently reaffirmed by the UK Supreme Court in two cases. One was brought by the British affiliate of a Russian state-owned bank, which sought to piece the corporate veil of its borrower, a Russian registered company, and hold liable its alleged controlling beneficial owner, a Russian individual, as well as several other companies controlled by him in the British Virgin Islands.[41] The prevailing English doctrine is that a court can pierce the corporate veil only when a person that was under an existing obligation deliberately evaded that obligation by interposing a company under his control, and then only for the purpose of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality.[42] The company must in itself, through its mere existence, be the instrument of the fraud or wrongdoing. The relevant point here, however, is that such judicial doctrines are not set in stone and can change over time to adapt to new circumstances. The current doctrine harkens back to 1990 and a seminal decision that year against the lifting of the corporate veil in the case of a U.S. subsidiary of a British group of companies – *Adams v. Cape*

[40] On this discussion, see *infra* part IV. In the European order, the quasi-unconditional recognition of companies that are validly registered in other Member States was established in a series of ECJ decisions beginning from 1999 (Case C-212/97, Centros Ltd. v. Erhvervs-og Selkabsstyrelserv, 1999 E.C.R. I-1459; Case C-208/00, Uberseering BV v. Nordic Construction Co. Baumanagement GmbH, 2002 E.C.R. I-9919; Case C-167/01, Kamer van Koophandel en Fabrienken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10155. Other ECJ decisions then determined to what extent jurisdictions may continue to apply their traditional "real seat theory" (i.e. the theory that requires that companies be governed by the company law of the place of their real seat, rather than their place of incorporation). *See* Case C-210/06, Cartesio, 2008 E.C.R. I-9641.

[41] VTB Capital plc v. Nutritek International Corp., [2013] UKSC 5 (Feb. 6, 2013). The other case is *Prest v. Petrodel Resources Ltd.*, [2013] UKSC 34 (June 12, 2013), regarding the holding of the family home by a company wholly owned by the husband.

[42] Prest v. Petrodel*,* *supra* note 41; *c*ommentary by Practical Law dated July 12, 2013, *available at* http://uk.practicallaw.com/2-532-9270?q=lifting+the+corporate+veil#null.

Industries.[43] Before *Adams*, under the leadership of Lord Denning, the English courts were more prepared to lift corporate veils, "if it was necessary to achieve justice, irrespective of the legal efficacy of the corporate structure under consideration," particularly within group structures involving wholly owned subsidiary companies.[44] The period 1966-1989 is thus described by a popular textbook as "interventionist years," during which "the courts seemed to treat the separate personality of the company as an initial negotiating position which could be overturned in the interests of justice."[45] It is not impossible to imagine that even in the United Kingdom, where the fiction of legal personality is considered to be "the whole foundation of English company and insolvency law"[46] (as in other countries surely), new circumstances and risks could lead to an evolution of the current doctrine and a turn towards more interventionist views by the courts.[47]

The growing cross-border use of corporate structures in non-transparent jurisdictions could be one of the circumstances that might justify such a change. Round-tripping often involves holding companies that are registered in jurisdictions that do not disclose any information on directors or shareholders (not to mention accounts), in turn creating risks for commercial counterparties, creditors and law enforcement bodies, all of which are unable to independently form an opinion on actual ownership chains, substance of activities and origins of funds. This structural opacity has led scholars to conclude that in some countries, round-tripping is exclusively the province of corruption and money-laundering.[48] This is too sweeping an indictment: if a holding company is registered in a jurisdiction that provides some degree of corporate transparency (as is the case in the EU, for example), legitimate arguments can justify the round-tripping. But in practice things are complicated by the fact that there is seldom one single holding company involved. What we tend to see, in practice, are layers of holding companies, with the first bottom level holding company located in a transparent jurisdiction that has a tax treaty with the host country (e.g. Cyprus, the Netherlands, Mauritius), but above which further layers of holding companies are interposed in jurisdictions that are much more secretive (e.g. BVI or the Channel Islands). There are a number of classic examples of such multi-layered structures: the Russia-Cyprus-BVI structure, the China-Hong Kong-BVI structure, etc. Successive layers of holding companies become more and more opaque as one

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43 Adams v. Cape Industries plc, [1990] Ch 433.

44 Littlewoods Mail Order Stores v. IRC, [1969] 1 WLR 1241; DHN Food Distributors Ltd v. Tower Hamlets London Borough Council, [1976] 1 WLR 852; Re a Company, [1985] BCLC 333.

45 ALAN DIGNAM & JOHN LOWRY, COMPANY LAW ¶ 3.14 (8th ed. 2014).

46 Prest v. Petrodel, *supra* note 41, at ¶ 8.

47 For a French call for enhanced judicial interventionism and substance-over-form analysis in the field of company law, see Sophie Schiller, *La fraude, nécessaire "deus ex machina" face à l'évolution du droit des sociétés*, 2014/4 REV. DES SOCIETES 211.

48 *See, e.g.*, Svetlana Ledyaeva, Paivi Karhunen & John Whalley, *Offshore Jurisdictions (Including Cyprus), Corruption, Money Laundering and Russian Round-trip Investment (*Nat'l Bureau of Econ. Research Working Paper No. 19019, 2013).

climbs up the ownership chain. Ultimately, at the very top, one may then find trust structures dissociating legal title (and management rights) from equitable ownership, at which point the identification of beneficial ownership and actual control can often become insuperable.

One now returns to the original question, which was the policy view that could be adopted regarding the use of round-tripping to allow access to more sophisticated legal systems. At present, most Western courts hearing commercial disputes accept these structures at face value and in ordinary circumstances do not lift any corporate veils. In theory, if the technique only involved transparent jurisdictions that disclose the identities of directors, shareholders and possibly even accounts, it could be viewed as beneficial or at least devoid of sufficiently harmful effects ("negative externalities"). In practice, however, the reality is that round-tripping often involves entities in non-transparent jurisdictions through which the *ex ante* tracking of ownership and control becomes almost impossible. When such structures are used, the legitimate quest for better legal infrastructure mutates into deliberate opacity that shields ownership and control from any external observation. In practice it can sometimes be difficult to distinguish this from the "misuse" of corporate personality against which a global consensus is now being formed.[49]

C. *Property Rights Protection*

The last objective that was identified for round-tripping is to achieve the protection of property rights under international investment law. It was never evident, to begin with, that round-tripping investors would be treated as foreign investors under the ICSID Convention and investment treaties. However, arbitral awards in recent years have confirmed that in the normal course, this will often be the case. The debate erupted to the forefront in a 2004 ICSID case regarding a claim against Ukraine by a Lithuanian company that was wholly owned by Ukrainian individuals.[50] Based on the language of the Lithuania-Ukraine BIT, the majority of the arbitrators ruled that the claimant qualified as a "foreign investor," the only condition being incorporation in the other contracting state (in that case Lithuania). The chairman of the tribunal, Prosper Weil, disagreed. In a dissenting opinion he defended the view that investment treaties should be interpreted in light of their purpose and that of the ICSID Convention, which are to promote *international* investment. Tellingly, he couched the debate along the public/private divide, arguing that investment law is a branch of public law and should therefore privilege substance-over-form over private ordering, and also that it was not acceptable to allow investment law to become a tool for evasion from the jurisdiction of domestic courts:

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[49] *See supra* note 32.

[50] Tokios Tokeles v. Ukraine, ICSID Case No. ARB/02/18, Decision on Jurisdiction of April 29 2004 (with a dissenting opinion by Prosper Weil), *available at* https://icsid.worldbank.org/ICSID.

> Insofar as business law and issues of business liability are involved, there is no need for denying effect to the corporate structure chosen by the economic agents. When it comes to mechanisms involving States and implying, therefore, issues of public international law, economic and political reality is to prevail over legal structure, so much so that the application of the basic principles of public international law should not be frustrated by legal concepts and rules prevailing in the relations between private economic and juridical players. The object and purpose of the ICSID Convention is not – and its effect, therefore, should not be – to afford domestic, national corporations the means of evading the jurisdiction of their domestic, national tribunals.[51]

Prosper Weil's views remain in the minority to this day. In investment arbitration, round-tripping structures are treated no differently from ordinary cases of treaty shopping through corporate "nationality planning." There is a line that separates legitimate nationality planning from an abuse of treaty rights, which depends on the timing of the corporate structuring,[52] but the circumstance that the ultimate beneficial owners or controllers are themselves nationals of the host state does not seem to play a role.[53] If the claimant is incorporated in an appropriate

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[51] *Id.* at ¶ 24.

[52] Yael Ribco Borman, *Treaty Shopping Through Corporate Restructuring of Investments: Legitimate Corporate Planning or Abuse of Rights?, in* HAGUE Y.B. OF INT'L LAW 359 (Nikos Lavranos et al. eds., 2011); Mark Feldman, *Setting Limits on Corporate Nationality Planning in Investment Treaty Arbitration,* 27 ICSID REV. 281 (2012).

[53] *The Rompetrol Group NV v. Romania*, ICSID Case No. ARB/06/3, *available at* http://www.italaw.com/cases/920, involved a BIT claim by a Dutch holding company owned and controlled by a Romanian investor. The tribunal found that "neither corporate control, effective seat, nor origin of capital has any part to play in the ascertaining of nationality under The Netherlands-Romania BIT." Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, April 18, 2008, ¶ 110. *KT Asia Investment BV v. Republic of Kazakhstan*, ICSID Case No. ARB/09/8, 2013, *available at* http://www.italaw.com/cases/2277, involved a BIT claim by a Dutch holding company which was beneficially owned by Mukhtar Ablyazov, a Kazakh national. The tribunal found that the claimant (a Dutch holding company) qualified as a protected "investor." However, its shares in Kazakh bank BTA did not qualify as a protected investment, and therefore jurisdiction under the Kazakh-Netherlands BIT was ultimately denied (the claimant had purchased its shares from BVI companies under the control of Mr. Ablyazov at an undervalue and through loans which it had failed to repay). *Azpetrol International Holdings B.V., Azpetrol Group B.V. and Azpetrol Oil Services Group B.V. v. The Republic of Azerbaijan* involved an ECT claim in which the claimants were controlled by an Azeri national, but the case was dismissed on another jurisdictional ground. ICSID Case No. ARB/06/15, Award, Sept. 8, 2009, *available at* http://www.italaw.com/cases/116. I do not claim to have performed an exhaustive review of all investment treaty cases involving round-tripping structures, but there are at least two cases that denied jurisdiction to round-tripping investors on that basis (neither cited by the *Yukos* tribunal). In *TSA Spectrum de Argentina, S.A. v. Argentine Republic*, ICSID Case No. ARB/05/5, Award, Dec. 19, 2008, the tribunal denied jurisdiction to an Argentine company that was majority owned by a Dutch company itself majority owned and controlled by an Argentine individual, by conflating Article 25(2)(b) of the ICSID Convention and the BIT definition of protected

contracting state[54] from the beginning of the investment, and subsequent corporate restructuring does not occur in order to blatantly "treaty shop," the likelihood is that the investor will qualify for investment treaty protection. This is because many treaties define covered "investors" as investors that exist as legal persons in the other state, without any additional requirement as to actual substance, ownership or control – the ECT is one such treaty, and it is now the treaty most invoked in investment disputes to this day, ahead of NAFTA.[55] These investment treaties mirror the company law "incorporation theory" that has become dominant in the last twenty years, and the comparative decline (at this moment in time at least) of the "real seat" theory.[56] The risk of treaty shopping is addressed elsewhere, in denial-of-benefits clauses. However, these are also being interpreted in a way that may render them virtually toothless.[57]

This now snow-balling body of arbitral precedents reflects the strength of the private law paradigm in investment arbitration at the jurisdictional stage. Only a few voices in the legal community have questioned this evolution. For Engela Schlemmer, the "offshore incorporation of companies for the specific purpose of taking advantage of BIT protection" has become an issue and would justify taking

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investor. The other case is *The Loewen Group Inc. and Raymond L. Loewen v. U.S.*, Case No. ARB(AF)/98/3, Award, June 26, 2003, a case under NAFTA regarding a Canadian claimant that was beneficially owned by a U.S. national. Here the views of the tribunal seemed very similar to those of Prosper Weil in *Tokios*:

> The format of NAFTA is clearly intended to protect the investors of one Contracting Party against unfair practices occurring in one of the other Contracting Parties. It was not intended to and could not affect the rights of American investors in relation to practices of the United States that adversely affect such American investors. Claims of that nature can only be pursued under domestic law and *it is inconceivable that sovereign nations would negotiate treaties to supplement or modify domestic law as it applies to their own residents*. Such a collateral effect on the domestic laws of the NAFTA Parties was clearly not within their contemplation when the treaty was negotiated (¶ 223) (emphasis added).

[54] *I.e.* in a jurisdiction that is a party to an investment treaty with the host state of origin which defines "investors" solely on the basis of "incorporation" or "registration" without any substance requirements – such as the ECT.

[55] *See* UNCTAD, *IIA Issues Note*, No. 1, Feb. 2015, *available at* http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf.

[56] On the competing "incorporation" and "real seat" theories in company law, see below Part IV. A.

[57] Feldman reviews the decisions in *Generation Ukraine*, *Plama*, *Yukos* and *Pan American Energy* and concludes that through their imposition of a rigid evidentiary burden on respondent states or the requirement that government notice be given *before* the dispute that treaty benefits will not apply, they "undermine the utility of denial of benefits provisions" and seem to set "unrealistic requirements" on respondent states. *See* Feldman, *supra* note 52, at 300 and 302. *See also* Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan, ICSID Case No. ARB/07/14, *available at* http://www.italaw. com/cases/1977, another ECT case. The interpretation of the ECT denial-of-benefits clause by the *Yukos* tribunal is addressed below, at part IV.A.

"another look at the tests to be applied in determining corporate nationality."[58] For M. Sornarajah, corporate nationality planning through "sandwich or postbox companies" has become a means to create jurisdiction beyond the consent of the contracting states.[59] He suggests that one of the reasons for this evolution is the inbuilt bias of arbitrators towards expansion of the investment arbitration system as a whole.[60]

Interestingly, the swirling public debate on investor-state investment arbitration ("ISDS") in new multilateral treaties has placed this particular issue squarely back into the lap of Western policy makers. On this issue at least, there seems to be unanimity, and the consensus view is that mere holding companies should *not* be able to claim benefits under investment treaties. The investment chapter of the published draft of the Canada-EU trade agreement defines a covered "investor" as an "enterprise that is constituted or organized under the laws of [a] Party" and that "has *substantial business activities in the territory of that Party*" (or that is directly or indirectly owned and controlled by such an entreprise).[61] The EU Commission's official view is that "mailbox companies" should not be able to bring cases to investment arbitration, and that in the new treaties "only companies with real business operations in the territory of one of the Parties will be covered by the investment protection provisions."[62] A similar view was extolled by the U.S. presidential administration in its defense of ISDS in the Transpacific Partnership.[63] However, as the *Yukos* awards demonstrate, these now apparently dominant policy views may be without impact on the interpretation by tribunals of the many existing treaties already in place that do not include express substance requirements.

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[58] Engela C. Schlemmer, *Investment, Investor, Nationality, and Shareholders*, *in* THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 50, 87 (Peter Mushlinski, Federico Ortini, & Christoph Schreuer eds., 2008). *See also* statements made by Christoph Schreuer at a Fordham Conference held in London on April 27, 2012, *reported at* http://law.fordham.edu/newsroom/27131.htm, and Christoph Scheuer, *Nationality Planning, in* CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS 2012 at 17 (Arthur W. Rovine ed., 2013).

[59] M. SORNARAJAH, RESISTANCE AND CHANGE IN THE INTERNATIONAL LAW ON FOREIGN INVESTMENT, Ch. 3, 177 (2015); M. Sornarajah, *Good Faith, Nationality Planning, and Denial of Benefits*, *in* GOOD FAITH AND INTERNATIONAL ECONOMIC LAW 117 (Andrew D. Mitchell, M. Sornarajah & Tania Voon eds., 2015).

[60] Sornarajah, *Good Faith, Nationality Planning, and Denial of Benefits, supra* note 59, at 129-30 and 133.

[61] Article X.3, *Consolidated CETA Text, 26 September 2014*, TRANSNAT'L DISP. MANAGEMENT, Sept. 2014 (emphasis added).

[62] EU Commission, *supra* note 7.

[63] "TPP will prevent sham corporations from accessing the investment protections provided by the agreement." *See supra* note 8.

IV. THE *YUKOS* CASE

A. *Corporate Structuring and the Private Law Paradigm*

The Yukos group was a classic example of investment round-tripping. The shares of the underlying Russian company, OAO Yukos, were held first by two holding companies registered in Cyprus and then at the next level in the Isle of Man and Jersey, all directly or indirectly owned by GML, a Gibraltar company, at the third level.[64] These foreign holding companies had been put in place in 1997,[65] i.e. right after the Yukos shareholders had obtained their controlling stake in OAO Yukos from the Russian state (under the "loans-for-shares" program). Beyond their own domestic tax attractiveness, the jurisdictions of incorporation had presumably been selected because they offered a tax treaty with Russia (Cyprus) and investment protection under the ECT (Jersey, Isle of Man, and Gibraltar being foreign dependencies of the United Kingdom, they benefit from its investment protection treaties). The next layer (above GML) involved seven BVI companies and eight Guernsey trusts, which had been created in March and October 2003.[66] The trustees were specialized Guernsey professionals. The Yukos shareholders had settled their GML shares into the trusts,[67] and were named as beneficiaries (Khodorkovsky, however, was removed as a beneficiary from his personal trust in October 2005). The former shareholders also took on the role of "protectors" (an institution of offshore trust law), whose consent was necessary for important decisions by the trustees. Call options were put in place to further control the GML shares. The Yukos trusts were similar to the types of asset protection trusts that have now become a commodity in the offshore wealth management industry. The main point of these structures, to simplify things, is wealth preservation by placing assets beyond the reach of creditors.[68] Settlors issue so-called "letters of wishes" that are not formally binding on the trustees, in which they set forth their wishes for the use of the trust assets. In point of reality, of course, corporate and tax practitioners are well aware that there is a clear, if unspoken, understanding that trustees will generally always try to follow the wishes or indications of the original settlors. There are a few judicial precedents that have struck down such

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[64] This is a summary. For the full chart of corporate shareholdings, see the Appendix to the Interim Awards on Jurisdiction and Admissibility, Nov. 30, 2009, *supra* note 1.

[65] Yukos Universal Limited (Isle of Man), Interim Award, ¶¶ 41-44 and 463. Veteran Petroleum Limited (Cyprus) was set up in 2001.

[66] *See supra* note 64.

[67] Khodorkovsky's portion in GML had already previously been settled into a Liechtenstein foundation, so the formal settlor into the Guernsey trust was the foundation.

[68] Offshore common-law jurisdictions have created a specialty area for themselves by adopting special trust laws that protect trust assets from claim by creditors. Similar levels of protection would not be achievable under the "orthodox" English law of trusts, because of the greater pro-creditor bias of English law (going as far back as the 1571 Statute of Elizabeth). *See* Geraint Thomas, *Asset Protection Trusts*, *in* THE INTERNATIONAL TRUST ¶¶ 6.1, 6.7 (John Glasson & Geraint Thomas eds., 2d ed. 2006).

trusts as shams, when the circumstances were extreme,[69] but these situations are viewed as exceptional and not reflecting the normal position that trustees must be respected, for all subsequent purposes, as being the legal and controlling owners of the trust assets.

So how did the ECT tribunal consider the Yukos corporate structuring for the purposes of applying the ECT? The question was central, for the tribunal's jurisdiction depended upon it. If the ownership structure was set aside as a construction seeking to disguise the ownership of the Russian shareholders in order to benefit from investment treaty protection, the claimants would perhaps not qualify as protected investors owning qualifying investments under the ECT and the tribunal would not have jurisdiction. The Russian government, as respondent in the proceedings, set out its arguments in two limbs. First, it argued that the claimants (the two Cypriot companies and the Isle of Man company) did not qualify as foreign investors ("Investors") under Article 1(7) of the ECT, because they were shell companies, and did not "own or control" the shares of OAO Yukos under Article 1(6)b of the ECT. Rather these were under the "actual control" of the Russian beneficiaries. The second limb was placed under the denial-of-benefits clause of the ECT, Article 17. There, the government's argument went, the claimants had no substantial business activities and were in fact under the ownership and control of nationals of third countries. Therefore the Russian government was entitled not to extend the benefit of the treaty protections to them. Both limbs involved looking at the substance, activities, ownership and control of the Cyprus and Isle of Man companies. In summary, according to the respondent:

> The Tribunal lacks jurisdiction *ratione personae* and *materiae* (a) because Claimants are shell companies, (b) because Claimants are owned and controlled by Russian oligarchs, including Khodorkovsky, Lebedev and other Russian nationals, and (c) because Claimants are mere nominees who do not own or control the Yukos shares that are the subject of these proceedings.[70]

None of these arguments were successful with the tribunal. Based upon the plain wording of the definition of "Investors" in the treaty (at Article 1(7)), it decided that the only requirement was that the claimants be "organized in accordance with the law applicable" in a contracting state. The tribunal did not find itself "entitled, by the terms of the ECT, to find otherwise,"[71] adding that

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[69] Rahman v. Chase Bank, [1991] JLR 103 (a Jersey trust for which the settlor had retained extensive powers over the assets); Midland Bank v. Wyatt, [1985] 1 FLR 696 (a sham declaration of trust in which the settlor named himself as trustee); R v. Allen, [1999] STC 846 (two trusts, one in Jersey and one in Gibraltar, for which the trustee did not possess any real power or discretion); Minwalla v. Minwalla, [2005] FLR 771 (a Jersey trust for which the settlor had produced two contradictory letters of wishes). *See* Frank Hinks QC, *Sham Trusts,* Practical Law, http://uk.practicallaw.com/6-383-2143?q=sham+trusts.

[70] *Yukos Universal Limited (Isle of Man)*, Interim Award, ¶ 42, at 28.

[71] *Id.* ¶ 413.

> other arbitral tribunals have … emphasized that the reference to the State of incorporation is the most common method of defining the nationality of a company and that, in any event, once a treaty makes that choice in specific and unambiguous terms, any other method of assessing the company's nationality is ruled out.[72]

The tribunal did not believe that the rule of interpretation of treaties set out in Article 31 of the Vienna Convention on the Law of Treaties, in accordance with which a treaty must be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose," gave it the right to look beyond the single criteria of incorporation.[73] In support of its finding the tribunal cited *Plama v. Bulgaria* (also a Cyprus claimant under the ECT),[74] *Tokios Tokeles* and *Saluka Investments BV (The Netherlands) v. The Czech Republic.*[75] It cited sections of the *Saluka* award in which the *Saluka* tribunal had expressed "some sympathy for the argument that a company which has no real connection with a State party to an investment treaty, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that State, should not be entitled to invoke the provisions of that treaty. Such a possibility lends itself to abuses of the arbitral procedure." However, the *Saluka* tribunal had also declared that it could not "impose upon the parties a definition of "investor" other than that which they themselves agreed," that "that agreed definition required only that the claimant-investor should be constituted under the laws of [in that case] The Netherlands," and that it "was not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add."[76]

It may be useful at this point to pause and consider the reasoning of the tribunal in connection with the criterion of incorporation. The general idea underlying the tribunal's view (following that of the *Saluka* tribunal) is that sovereign states gave their consent to the proposition that mere incorporation (i.e. incorporation without attendant substance) would be sufficient for investment protection under the ECT (signed in 1994) or the Netherlands-Czechoslovakia BIT (signed in 1991). It could be pointed out, however, that within the European Union at least, these treaties predated an era of fundamental change in the rules of

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[72] *Id.* ¶ 416.

[73] The Russian government is challenging the tribunal's interpretation of the ECT before the district court of the Hague in its annulment claim against the three awards. *See* writ of summons (¶¶ 262-276) and appended claim documents, *available at* http://www.italaw.com/sites/default/files/case-documents/italaw4158_0.pdf (regarding Veteran Petroleum Limited) and also the Russian government's website post of Feb. 6, 2015, at http://old.minfin. ru/en/news/index.php?id_4=24358.

[74] Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No.ARB/03/24, Decision on Jurisdiction of Feb. 5, 2005, *available at* http://www.italaw.com/cases/ documents/858.

[75] Saluka Investments BV (The Netherlands) v. The Czech Republic*,* Partial Award dated March 17, 2006, ¶¶ 240 and 241.

[76] *Yukos Universal Limited (Isle of Man),* Interim Award, ¶ 414.

private international law governing domestic companies and the recognition of companies formed in other states, beginning with the *Centros* decision of 1999.[77] Before these changes, a number of EU countries applied the "real seat" theory according to which companies are governed by (i.e., *deemed to exist under*) not the laws of the country in which they were registered, but those of the country in which they have their real seat of operations (as opposed to their place of registration or incorporation). The criterion in the Netherlands-Czechoslovakia treaty and in the ECT is that the investor be a "legal person" and "constituted in accordance with the laws" of one of the parties – this is not necessarily equivalent to "incorporation." One would need to research the historical positions of each signatory country to determine which theory (incorporation or real seat) was applied at the time of entering into the relevant investment treaty, a task beyond the scope of this article, but it is possible to state, at the very least, that for countries that applied the "real seat" theory, mere registration without substance in those countries would normally be *insufficient* to confer quality as a legal person under their domestic laws at the time, and would therefore be equally insufficient to confer quality as a protected investor under their investment treaties. The point here is not to challenge that incorporation is the relevant criterion at present in the relevant contracting states, or at the time the disputes arose, but that domestic legal categories such as these are not set in stone and may evolve over time; accordingly, the idea of sovereign consent having been conceded once and for all regardless of future evolutions that might affect the status and recognition of legal entities within the domestic and international orders seems like a methodological leap that does not declare itself. That many sovereigns would, upon proper consideration of the matter, refuse protected investor status to companies without substance has been made clear by the recent positions expressed in this regard by the EU Commission and U.S. presidential administration.[78]

The argument regarding the absence of any actual foreign investment by the Yukos claimants was likewise also disposed of, on the basis of a literal reading of the definition of "investment" under Article 1(6) of the ECT. The tribunal did not find itself "entitled, by the terms of the ECT, to find otherwise."[79] It did not rebut or even cite Prosper Weil's dissenting opinion on investment round-tripping in *Tokios Tokeles*. It is notable that this part of the *Yukos* tribunal's reasoning was not followed in *KT Asia*, a later case regarding Kazakhstan with some interesting similarities to the *Yukos* case.[80]

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[77] On *Centros* and subsequent ECJ decisions, see *supra* note 40.

[78] See *supra* notes 7 and 8.

[79] *Yukos Universal Limited (Isle of Man)*, Interim Award, ¶ 435.

[80] The *Yukos* awards did not include a detailed review of the manner in which the Yukos shares were first acquired by the claimants, or whether the price of acquisition reflected market value at the time. This is in contrast with the lengthy discussion in *KT Asia*, *see supra* note 53, on the mode of acquisition, by the Dutch claimant, of its shares in Kazakh bank BTA (¶¶ 160-223); the tribunal's conclusion was that the shares did not qualify as an investment under the BIT.

The denial-of-benefits defense, for its part, was set aside by the *Yukos* tribunal on the ground that the Russian government should have notified the claimants *before* the dispute that it would not extend treaty benefits to them – a reasoning that did not require any review of the substance, ownership or control over the claimant companies.[81] It is interesting therefore that the tribunal went out of its way, nevertheless, to produce an *obiter* analysis of this defense. The Russian government's argument was that the companies were shell companies that did not conduct any substantial business activities and furthermore were owned and controlled by citizens or nationals of a third state (either Russia or Israel, as some of the beneficiaries had Israeli citizenship). The Guernsey trustees did not have ownership or control of the assets and were mere nominees. The government's argument was supported by an expert opinion provided by Martin Mann QC, a practitioner of trust law, which was countered by a contrary opinion provided by another practitioner of trust law, Brian Green QC. The claimants accepted that they did not have any substantial business activities in Cyprus or the Isle of Man. However, they defended the trust structures as valid and conferring ownership and control to the professional trustees. On these issues of trust analysis, as for all of the other questions that concerned the validity of the corporate structuring implemented by the Yukos shareholders, the tribunal sided with the claimants. The main reason was that it found no reason to unsettle the offshore trusts, which it described as "a centuries-old" common-law institution:

> The Tribunal notes that transferring ownership of assets to a trustee pursuant to a trust instrument is a centuries-old institution of the English common law. Settling certain properties into a trust, thus transferring legal ownership to a trustee and adopting provisions with regard to beneficiaries – including leaving their establishment at the trustee's discretion, subject to the powers of a protector as the case may be – is a well-established institution at common law, which is recognized internationally today pursuant to the Hague Convention on the Law Applicable to Trusts and their Recognition of 1 July 1985. The Tribunal sees no reason to unsettle a centuries-old legal institution when the trust instruments at hand do not depart from standard forms used in countless other similar settlements. To do so would put into question the validity of the very concept of trusts at a time when their recognition goes well beyond the common-law countries. Indeed, in recent years, trusts have found a significant measure of acceptance in some civil law jurisdictions, although there is no evidence before the Tribunal that they are accepted instruments in Russian law.[82]

To a civil-law educated reader this reasoning surprises by its lack of acknowledgement of the very real difficulties that trusts, especially offshore trusts,

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[81] *Yukos Universal Limited (Isle of Man),* Interim Award, ¶ 456. The tribunal followed the decision in *Plama* (see above Feldman's critique *supra* note 57). The Russian government had argued that the denial-of-benefits clause should not require prior notification, and it also claimed an analogy with the 1997 Partnership and Cooperation Agreement between Russia and the EU, under which the Cyprus and Isle of Man claimants would not have been afforded treaty benefits.

[82] *Yukos Universal Limited (Isle of Man)*, Interim Award, ¶ 535.

continue to pose in civil-law countries.[83] Very few civil-law countries have ratified the Hague Convention on Trusts, and those that did were all specialized jurisdictions as defined elsewhere in this article – with the sole exception of Italy, admittedly.[84] In civil-law systems trusts tend to be disregarded and considered as look-through entities. France, for example, has only recently clarified the treatment of foreign trusts for the purposes of taxation; in essence either the settlor or the beneficiary is considered the owner of the assets or income, and the presence of the foreign trustee is largely disregarded except to impose reporting obligations.[85] In the *Yukos* awards, however, the approach of the tribunal to the Guernsey trusts was grounded in the unconditional private law recognition of these institutions solely in accordance with the law of their creation (i.e. Guernsey law). The Russian law effects that such trusts might have for the Russian settlors or beneficiaries were not examined and presumably considered irrelevant, as demonstrated by the tribunal's passing reference to the absence of "evidence before the Tribunal that they are accepted instruments in Russian law."

B. *Tax Avoidance and the Public Law Paradigm*

In short, the *Yukos* tribunal upheld the corporate round-tripping structure implemented by the Yukos shareholders for the purpose of establishing its jurisdiction and the availability of investment protection under the ECT. It is all the more surprising, therefore, that in a final twist the tribunal nevertheless gave a significant nod to the public law paradigm, at the moment of determining the quantum of damages that would be payable by the Russian government. This was in response to the "unclean hands" defense that the respondent had unsuccessfully

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[83] Indeed, even in England there is a discussion on how to deal with certain forms of offshore trusts. *See, e.g.*, ALISTAIR HUDSON, EQUITY AND TRUSTS 951-53 (6th ed. 2010).

[84] *See supra* note 14 on specialized jurisdictions. The civil-law countries having ratified the Hague Convention on Trusts are the Netherlands, Luxembourg, Switzerland, Monaco and Italy. In total only 12 countries have ratified the Convention (including the United Kingdom and its dependent territories).

[85] *Bulletin Officiel des Finances Publiques-Impôts* BOI-ENRDMTG-30-20121016 (regarding transfer and estate taxes) and BOI-PAT-ISF-30-20-30-20121016 (regarding wealth tax and an equivalent tax on assets), Oct. 16, 2012. The French tax authorities' interpretation of trusts is at BOI-DJC-TRUST-20150304, Mar. 4, 2015. Their definition of foreign trusts is similar "in substance" to the definition set out in the Hague Convention. However, they pointedly indicate that the Convention was not ratified by France and that trusts have *not* been introduced into French law – their comments are only to clarify the treatment of foreign trust "structures" under the rules of French tax law (¶ 50). In the case of corporate or fiduciary settlors, French tax law redefines the settlor ("*constituant*") as the ultimate beneficial owner or principal of such corporates or fiduciaries, i.e. it disregards these intermediary structures (*id.* ¶ 90). French law also imposes annual reporting obligations on trustees (including foreign trustees) that are sanctioned by significant fines. These measures are viewed by most practitioners as reflecting general hostility towards the trust, as also illustrated by the introduction of a competing French vehicle for the fiduciary management of assets ("*fiducie*").

put forward, in an attempt to argue that investment protections should be denied altogether. The tribunal refused to read a "clean hands principle" or "legality requirement" into the ECT (save at the moment of effecting the investment). However, it decided that some instances of "illegal and bad faith" conduct by the claimants should nevertheless have an impact on the assessment of damages,[86] as constituting "contributory faults." Unsurprisingly, these contributory faults were the tax optimization schemes that had been used by Yukos: the domestic schemes that were the center of the Russian government's domestic tax cases, and Yukos' use of the Cyprus-Russia double tax treaty. The exact percentage of Yukos' contributory fault, which the tribunal discretionarily set at 25%, was nothing short of mysterious, but the result was very significant as it reduced the financial award by some $17 billion.[87]

What explained this switch to a public law substance-over-form approach at the time of assessing damages? Apparently it was the sham nature of some of the structures used by Yukos in the Russian low-tax regions, which had captured the attention of the tribunal:

> While there is ample evidence in the record that nearly all Russian oil companies also availed themselves of such tax optimization arrangements which were permitted by law, there is no evidence that the operations of those other oil companies, in any respect, breached the legislation and abused the low tax regimes as the Tribunal has found Yukos did through the sham-like nature of some elements of its operations in at least some of the low tax regions notably the ZATOs of Lesnoy and Trekhgorny.[88]
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> . . .
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> Accordingly, even though the Tribunal has found that President Putin and his administration used Yukos' tax problems as a pretextual justification for setting in motion a plan to bankrupt Yukos, as opposed to just collecting the taxes that might have been legitimately assessed against the trading companies on the basis of the "bad faith taxpayer" doctrine, the Tribunal concludes that there is a sufficient causal link between Yukos' abuse of the system in some of the low-tax regions and its demise which triggers a finding of contributory fault on the part of Yukos.[89]

With regard to the Cyprus-Russia double tax treaty, the tribunal felt likewise that it would somehow be too lenient to allow the first-level Cyprus holding companies to keep all of the benefits that had been obtained under that treaty:

> It seems clear to the Tribunal, on the facts, that Yukos' operations under the DTA were wholly conducted by Mr. Lebedev from Yukos' established offices in Moscow, that his "place of management" where he habitually concluded contracts relating to operations under the Treaty was in Moscow, which of itself

[86] *Hulley Enterprises Limited (Cyprus)*, Final Award, ¶¶ 1374, 1634.
[87] *Id.* ¶¶ 1637, 1827.
[88] *Id.* ¶ 1611.
[89] *Id.* ¶ 1615.

> demonstrates that Yukos' avoidance of hundreds of millions of dollars in Russian taxes through the Cyprus-Russia DTA was questionable. Hulley appears to the Tribunal to have falsely declared on Cypriot withholding tax forms that "income" – dividends from Yukos – "was not connected with activities carried on in the Russian Federation" despite Mr. Lebedev's activities in Moscow.[90]

The tribunal's conclusion was that the claimants "should pay a price for Yukos' abuse of the low tax regions by some of its trading entities, including its questionable use of the Cyprus-Russia DTA, which contributed in a material way to the prejudice which they subsequently suffered at the hands of the Russian Federation."[91] In ruling in this manner (and in particular on the "questionable use of the Cyprus-Russia DTA"), the tribunal was in fact revisiting the most key element of the Yukos corporate round-tripping structure, i.e. the ability to claim tax treaty protection for the holding companies at the bottom of the structure (here, in Cyprus). Indeed such structures are only commercially viable if profits can be distributed upwards by the active "onshore" companies (here, the Russian business units) without significant tax costs, through the benefit of tax treaties. The tribunal struck down these benefits without looking at (or at least citing) the relevant provisions of the tax treaty that it was purporting to interpret, regarding in particular the definitions of "residency" or "permanent establishment." One could have expected to see some analysis of the substantive provisions of the tax treaty, rather than a mere reference to the tax residency certificates that had been signed by the Cypriot directors. Whereas the definition of "investor" under the ECT had given rise to dozens of paragraphs of analysis, one of the most critical elements of Yukos' tax planning was summarily dismissed in a few words, without any reference to the language of the tax treaty. This discrepancy between the lengthy interpretation of the ECT and the lack of any attention to the language of the Cyprus-Russia tax treaty is striking.

At least one other commentator of the *Yukos* awards has expressed discomfort with the manner in which the Yukos tax optimization schemes were characterized as contributory faults, pointing out the contradiction with the tribunal's overall finding that tax laws were used as a mere pretext for expropriation. If taxation was a mere pretext, then there could be no logical causal link between the expropriation and the alleged tax evasion by the claimants.[92] There is another angle to this, however, in connection with the public/private paradigm. On the facts, the tribunal acknowledged that the Cypriot companies were managed from Moscow, by top executives of Yukos, and not therefore by the Cypriot nominee directors. These facts led the tribunal to disqualify the claimants from claiming benefits under the Cyprus-Russia tax treaty, as mentioned above a treaty that the ECT tribunal interpreted "synthetically" without citing its actual language or provisions. The same circumstances, however, were insufficient to disqualify the companies from being covered "investors" under the ECT, this on a literal reading

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[90] *Id.* ¶ 1620.
[91] *Id.* ¶ 1634.
[92] Sadowski, *supra* note 2.

of the ECT after paragraphs of analysis. This approach might uncharitably be viewed as an attempt by an arbitral tribunal to acknowledge the growing importance of the public law paradigm while at the same time preserving the institution of investment arbitration in its current form through continued respect for party autonomy and private ordering. A less uncharitable view would be that in matters of taxation, the public paradigm is utterly prevailing and must be implemented without need for any specific review or interpretation of treaty language.

V. CONCLUSION

Round-tripping works today because of the current power, in the field of transnational corporate structuring, of the private law paradigms of party autonomy and private ordering. It is facilitated by the dominance of the "incorporation" theory in company law and private international law. It is further encouraged by existing investment arbitration practice, which adopts a literal, formalistic interpretation under many investment treaties of corporate nationality at the jurisdictional stage. In doing so tribunals confirm their own jurisdiction over disputes, but the message that they send to domestic investors in emerging countries is that round-tripping is not only sensible, but should be deployed whenever possible. The *Yukos* case is a powerful incentive to implement round-tripping structures in high-risk countries that have entered into investment treaties with countries that apply the incorporation theory without adding in express substance requirements. The alternative would have been to revisit and perhaps adopt some portions of Prosper Weil's public law approach to investment arbitration.

There is a competing trend in other fields of law, however, that pulls in the other direction. The trend originated in the fight against corruption, money laundering and tax evasion, through global measures seeking to increase transparency and accountability in the use of corporate structures. It is clearly expressed in the design of new investment treaties. The effort is grounded in a general public law paradigm privileging economic substance over legal form. It is gaining momentum not only in the large Western countries and their global emanations (such as the FATF or OECD), but also at the G20 level and in large emerging countries such as China, India or Russia. These emerging countries are already implementing domestic tools against round-tripping. The tools are mainly administrative and tax oriented. However, in some cases corporate veil piercing and substance-over-form re-characterization is beginning to occur in private law settings as well.[93] Investment arbitration tribunals, however, following in the footsteps of other leading Western dispute resolution venues in the field of private

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93 See, for example, a resolution of the highest Russian commercial court, formerly known as the Supreme Arbitrazh Court, which ruled that failure by a company registered in the Dominican Republic to disclose its beneficial ownership justified blocking the recognition of its rights in a property dispute (Resolution No. 14848/12 of Mar. 26, 2013).

law, are still loath to piece corporate veils, except in very exceptional circumstances.

As paradigms evolve, however, and the public law paradigm gains more traction, perhaps investment tribunals could consider changing their views and becoming more critical of certain forms of corporate structuring, even within the current simple “incorporation” language of many investment treaties. This may lead to the development of models on how to approach the difficult task of substance-over-form re-characterization in a transnational context, setting examples that could then be followed by courts or tribunals in less mature legal environments. This might also enable to progressively align the approaches to round-tripping in discrete fields of law, thereby reducing opportunities for arbitrage and enabling efficiency gains through simplification and greater transparency. A final (admittedly more debatable) benefit might be to keep a larger number of economically significant disputes under the jurisdiction of domestic venues, in time enabling these institutions to accumulate the necessary experience and achieve a better understanding of transnational business and economics. In the words of Professor Weil, the object and purpose of investment arbitration was not to afford domestic investors the means of evading the jurisdiction of their domestic courts. Large scale round-tripping leads to the systemic outsourcing of domestic disputes to foreign venues, both for investment disputes with states and private commercial disputes. This may not be a long term solution for developing or emerging nations. Ultimately, improvement of domestic protection of property rights in these countries has to involve some form of empowerment of their local dispute resolution institutions, however long that road may take.