

Investment Funds and International Investment Arbitration



Ángela Gil-Arrondo

International Arbitration and Litigation

Investment funds have greatly expanded their international activities in recent years and participate in a large number of international investment transactions that take place every day around the world. Therefore, they are strong candidates for international investment agreement ('IIA') protection, including redress for state measures that constitute a violation of the IIA standards of protection.

Yet, the typical characteristics of investment funds could serve as a basis for denying them protection under IIAs on the grounds that they do not fall within their definition of 'investor' or 'investment'. The definitions of these terms are key treaty features that define the beneficiaries of the protection provided by IIAs, including the right to bring claims before international arbitral tribunals.

This article aims to identify the jurisdictional objections that investment funds, their unitholders or management companies may encounter when trying to avail themselves of the protection of an IIA.

Common Traits of Investment Funds

Before analysing the jurisdictional challenges faced by investment funds in international investment arbitration, it is important to first describe the common traits of investment funds.



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Firstly, investment funds are a type of collective investment scheme in which various individuals or organisations, known as unitholders, pool their money to form a separate basket of assets, which is managed by a third party and invested in a range of securities and assets with the aim of producing capital gains or income for the fund's unitholders.¹

The investment fund is divided into units which represent an investor's part

¹ This article focuses on collective investment schemes that do not adopt a corporate structure. Therefore, it is not applicable, for example, to investment companies with variable capital (SICAVs) regulated under Spanish law. In this regard, there are two main types of collective investment schemes under Spanish law: investment funds and SICAVs. The main difference between them is that a SICAV takes the form of a corporation (and therefore has legal personality). Like any other collective investment scheme, the SICAV's corporate purpose is to raise funds, assets or rights from the general public to manage them and invest them in assets, rights, securities or other instruments, financial or otherwise, and the investor's return is established according to the collective results.

ownership of the fund and the income it generates.

Another common trait is that the investment fund industry is highly regulated. Every major economy has specific rules on the authorisation, registration, legal nature, marketing, and sale of funds. However, those regulations differ by country and region.²

There is also a wide range of investment funds that vary according to their form, the type of assets they invest in, their

² Within the European Union, there is considerable harmonisation in the field of investment funds. Both the Undertakings for Collective Investment in Transferable Securities Directive 2009/65/EC (<<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0065&from=EN>> accessed 29 April 2021) and the Alternative Investment Fund Managers Directive 2011/61/EU (<<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0061&from=ES>> accessed 29 April 2021) regulate key issues such as the cross-border marketing of investment funds.

investment objectives, and the type of returns they seek.³

Investment Funds and the Notion of 'Investor'

In order for an investment fund to be protected under an IIA it must fall under the definition of 'investor' set out in the corresponding IIA and, in the event of proceedings under the Arbitration Rules of the International Centre for Settlement of Investment Disputes (ICSID), it must also qualify as an investor under article 25(2)(b) of the ICSID Convention.⁴

Two general issues usually arise in defining the term 'investor': what types of person or entity may be considered investors, and the links between the legal person and a contracting party to an investment agreement.⁵

Most investment treaties define the term 'investor' as covering both natural and legal persons or legal entities. Sometimes the term 'investor' is not used; instead the agreements refer to 'nationals' and 'companies,' with the latter including a range of legal entities.⁶ The category of legal entities can be defined to exclude a number

³ See different types of investment funds under Spanish law at '*Tipos de fondos*', Comisión Nacional del Mercado de Valores (free translation: 'Types of funds, Stock Market National Commission') <<https://www.cnmv.es/Portal/Inversor/Fondos-Tipos.aspx>> accessed 29 April 2021.

⁴ ICSID Convention (entered into force 14 October 1966).

⁵ UNCTAD, 'Scope and Definition' in *UNCTAD Series on Issues in International Investment Agreements II* (United Nations, New York and Geneva, 2011), 13 <https://unctad.org/system/files/official-document/diaeia20102_en.pdf> accessed 23 November 2020.

⁶ Ibid 14-15.

of different types of entities on the basis of their legal form, purpose or ownership structure. For example, some investment treaties only cover those entities that have legal personality, while others also include those without it.⁷

In some jurisdictions investment funds lack independent legal personality, as is the case in Spain, which means they may lack standing if the IIA has a restrictive definition of 'investor'.

The lack of legal personality was raised in *Renta 4 et al v Russia*,⁸ with regard to the meaning of 'investor' under the Russian Federation-Spain BIT,⁹ and in *Impregilo v Pakistan*¹⁰ in respect of the same point but under Article 25 of the ICSID Convention.

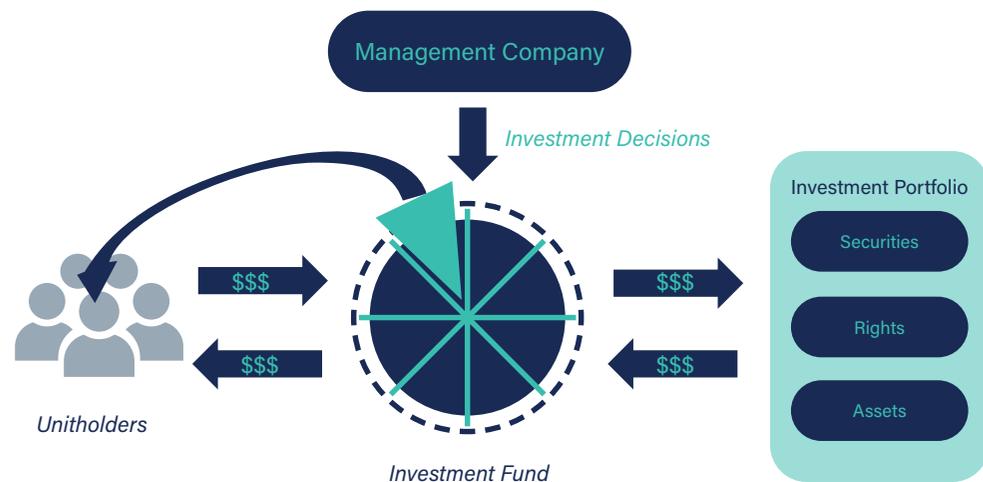
In *Renta 4 et al v Russia*, in which the applicable IIA used the term 'corporate body' to define the term 'investor', the tribunal found that three of the claimants, all of them Spanish investment funds, lacked legal personality. As a consequence, they did not qualify as corporate entities under the laws of the

⁷ Ibid 80.

⁸ *Renta 4 S.V.S.A., Ahorro Corporacionemergentes F.I., Quasar de Valores SICAV S.A., Orgor de Valores SICAV S.A., GBI 9000 SICAV S.A., ALOS 34 S.L. v The Russian Federation*, SCC Case No 024/2007, Award on preliminary objections (20 March 2009) ('*Renta 4 et al v Russia*').

⁹ Free translation: Agreement for the promotion and reciprocal protection of investments between the Kingdom of Spain and the Union of Soviet Socialist Republics (signed 26 October 1990, entered into force 28 November 1991) (Russian Federation-Spain BIT).

¹⁰ *Impregilo S.p.A. v Islamic Republic of Pakistan*, ICSID Case No ARB/03/3, Decision on jurisdiction (22 April 2005) ('*Impregilo v Pakistan*').



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Investment funds, their unitholders or management company may not generally qualify as an 'investor' under IIAs due to the organisational structure and the nature of the funds that seek protection

state in which the funds were created (Spanish law) and they were not an 'investor' for the purposes of the IIA, and thus lacked legal standing.¹¹ However, the dissenting opinion of one of the members of the arbitral tribunal,¹² while concluding that the funds were not corporate entities, argued that the term corporate entity should be interpreted under international law, i.e. 'any legal entity (other than a physical person) provided that it has been established' and not under domestic legislation.

In *Impregilo v Pakistan*, in which the claimants brought an action on behalf of a joint venture, the tribunal found that, since a joint venture under the applicable domestic law had no legal personality, it did not fall within the definition in Article 25 of the ICSID Convention, which is generally read as not covering associations without legal personality since this quality is inherent to the concept of 'juridical person'.¹³

Link Between the Investor and the Investment

Even if the applicable IIA's definition of 'investor' were to include an entity without legal personality, under many IIAs an investor must 'own' or 'control' directly or indirectly, the investment.¹⁴

Determining whether a particular investment can be regarded as belonging to an investment fund may be difficult because, in some jurisdictions, investment funds may not have the legal capacity to acquire and hold rights, and therefore property. In those jurisdictions, the assets held by the investment fund are directly owned by the unitholders or by the management company in trust for the fund. However, in those cases unitholders would not own any specific assets of the investment fund, but rather a share of the fund's aggregate assets, which in turn may raise further issues regarding the determination and



quantification of the damage suffered by the unitholder. Moreover, since the fund is managed by the management company, a tribunal may find that unitholders do not control those assets in any meaningful way.

Some of these issues were raised in *Gruslin v Malaysia*¹⁵ with regard to the legal standing of a unitholder of an investment fund created under the law of Luxembourg. *Mason v Korea*¹⁶ also considered the legal standing of the general partner of an

investment fund created under the law of the Cayman Islands.

In *Gruslin v Malaysia*, the respondent argued that Phillip Gruslin, as unitholder of an investment fund, was only entitled to the proper administration of the assets of the investment fund, and that no unitholder had any severable individual property right with respect to any investments made by such fund, which were the ones affected by the state's measures. Therefore, the claimant had no legal interest in the underlying Malaysian asset of the investment fund.

On the other hand, the claimant held that the ownership of assets that make up a collective investment is expressly

11 *Renta 4 et al v Russia*, paras 127-130.

12 *Renta 4 et. Al. v Russia*, Separate opinion of Charles N. Brower on preliminary objections (20 March 2009).

13 *Impregilo v Pakistan*, paras 131-134.

14 Jeswald W. Salacuse, 'The Nature and Content of Investment Treaties' Jeswald W. Salacuse (eds) *The Three Laws of International Investment: National, Contractual, and International Frameworks for Foreign Capital* (Oxford University Press, 2013), 376.

15 *Phillip Gruslin v Malaysia (II)*, ICSID Case No ARB/99/3, Award (27 November 2000) ('*Gruslin v Malaysia*').

16 *Mason Capital L.P. and Mason Management LLC v Republic of Korea*, PCA Case No 2018-55, UNCITRAL, Decision on Respondent's Preliminary Objections (22 December 2019) ('*Mason v Korea*').

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vested, under Luxembourg law and under the investors' contract with the management company of the portfolio, in the investors (unitholders) as opposed to the management company. The tribunal, however, left this question unanswered by declining jurisdiction on other grounds.

In *Mason v Korea*, where the claimant was the general partner of the fund, since the parties had agreed that the investment fund through which the affected investment was made lacked legal personality to own property under its domestic law, the tribunal concluded that under the applicable domestic law the general partner held all investment fund assets in trust for the investment fund and therefore 'directly owned' the affected investment.¹⁷

¹⁷ *Mason v Korea*, paras 151-163.

The respondent also raised the issue regarding whether the claimant, as a trustee of the investment fund, was the beneficial owner of the affected investment on the grounds of the general principle of international investment law that a claimant only qualifies as an investor if it can prove a beneficial interest in the investment. The arbitral tribunal, without deciding whether this general principle applied, merely concluded that, in any event, the general partner would also have beneficial ownership insofar as it had a right to a share of the profits from the fund's assets, which would make him a beneficial co-owner of each of the investment fund assets.¹⁸

Finally, in *Renta 4 et al v Russia* the tribunal found that the management

¹⁸ *Ibid* paras 164-187.

company or the depository could not bring a claim on behalf of the investment fund because the latter failed to meet the formal requirement to be an investor under the applicable IIA, nor could they bring a claim in their own names because they had not 'made' an investment since the underlying investment had been made by the fund.¹⁹

Investment Funds and the Notion of 'Investment'

It may also be debated whether an investment fund falls within the ordinary meaning of 'investment' provided for in the corresponding IIA. In this regard, it is worth noting that most IIAs contain a broad definition of investment, often referring to 'every type of assets' and then adding a specific non-exhaustive list of examples.²⁰

These definitions usually cover direct, as well as indirect, investments, and modern contractual and other transactions with economic value and thus cover (i) investment funds as an investment vehicle; (ii) investment fund assets regardless of their nature, such as debt or equity in a company; (iii) as well as the indirect interest that the unitholders may have in the investment fund assets.

However, some IIAs exclude from their scope portfolio investments by adding

¹⁹ *Renta 4 et al v. Russia*, paras 131-133.
²⁰ Andrew Newcombe and Lluís Paradell, 'Historical Development of Investment Treaty Law' Andrew Newcombe and Lluís Paradell (eds), *Law and Practice of Investment Treaties. Standards of Treatment* (Wolters Kluwer, 2009), 65-66.

to the definition of investment an element of management control over the investment. In this regard, a portfolio investment is an investment of a purely financial nature, where the investor remains passive and does not control the management of the investment.²¹ In this regard, however, an investment fund's investments could be seen as a portfolio investment since the management and the decisions regarding the investments fund's assets is performed by the management company. This rationale would also apply to the unitholder's investment and, therefore, it would preclude an investment tribunal's jurisdiction.

Conclusion

Although any potential jurisdictional objection will ultimately depend on the specific regulation at stake, investment funds, their unitholders or management company may not generally qualify as an 'investor' under IIAs due to the organisational structure and the nature of the funds that seek protection. It may also be debated whether an investment fund falls within the ordinary meaning of 'investment' provided for in the corresponding IIA.

Therefore, it will be key for investment funds, their unitholders or management companies to take into account the issues raised in this article when assessing whether recourse to investment treaty protection is available.

²¹ UNCTAD (n 6) 29.

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