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"Denial of Benefits" – practical lessons for states and investors from the *Pac Rim* arbitration

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Abstract

The *Pac Rim Cayman LLC v. The Republic of El Salvador* jurisdictional hearing marks the first time that any international tribunal has decided a "denial of bene-

1 The author was one of several counsel for Respondent, The Republic of El Salvador, during the Jurisdictional Phase of the hearings and was primarily responsible for briefing, hearing presentations, and witness examination on the denial of benefits defense raised by the Respondent. He is now a partner at Winston & Strawn LLP. The hearings took place from May 2-4, 2011 at the World Bank, Washington, D.C. The Tribunal consisted of Professor Dr. Guido Santiago Tawil, Professor Brigitte Stern, and V.V. Veeder, Esq. (President). The written Decision on the Respondent's Jurisdictional Objections is available on ICSID's website at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=viewCase&reqFrom=Home&caseId=C661&tab=Tab3. Citations to paragraphs of the Decision are noted herein as "D. ____." Mr. Badini gratefully acknowledges the assistance of Gianfranco J. Cuadra, Esq., an associate at Winston & Strawn LLP, in the preparation of this article.

fits" defense in the context of CAFTA. Indeed, such a defense has yet to be determined under the similar NAFTA treaty. The *Pac Rim* tribunal sustained such a defense, dismissing all CAFTA claims in the arbitration, on the basis that the claimant had no "substantial business activities" in any treaty state (other than in the respondent) and that claimant was owned by a "person of a non-Party," namely its Canadian parent corporation. The decision holds important lessons for both host states and investors and how investments should be structured in the common context of international conglomerate investors with numerous affiliates.

Keywords

Denial of benefits, denial of Benefits defense, jurisdictional challenge, CAFTA, CAFTA Article 10, substantial business activities, ownership or control, ICSID nationality, national, NAFTA, Pac Rim, Pacific Rim, Pac Rim Cayman LLC, Republic of El Salvador, ICSID arbitration, Convention on the Settlement of Investment Disputes, ICSID Jurisdiction, diplomatic protection

I Introduction

"Denial of Benefits" clauses are included in international treaties to guard against what has been described as the establishment of a "shell company" in a signatory territory for the sole purpose of availing oneself of treaty protections.[2] The United States has observed that such clauses are "consistent with a long-standing U.S. policy to … safeguard against the potential problem of 'free-rider' investors, i.e., third party entities that may only as a matter of formality be entitled to the benefits of a particular agreement."[3] When a government respondent shows that this is the case, the government may deny the benefits of the applicable treaty to the shell or "free-rider" claimant, including (according to some treaty language) the benefits flowing from the dispute resolution provisions of the treaty.

The ICSID arbitration ruling in *Pac Rim Cayman LLC v. The Republic of El Salvador* last year marks the first time that an international tribunal has ever resolved a "denial of benefits" defense under The Dominican Republic-Central America-United States Free Trade Agreement of 2004 ("CAFTA").[4] Indeed, no Tribunal has yet ruled on any such defense under the similar North American Free Trade Agreement ("NAFTA") regime.[5] The decision and its reasoning have significant implications both for State parties seeking to invoke the defense and for foreign investors who wish to structure their investments in a manner to avoid a possible successful "denial of benefits" invocation.

2 See Article 1113 – Denial of Benefits, in Investment Disputes under NAFTA, in: Meg N. Kinnear/Andrea K. Bjorklund/John F.G. Hannaford, An Annotated Guide to NAFTA Chapter 11, 1113-1, 1113-6, n. 33, Alphen aan den Rijn [et al.] 2006.

3 D. 4.55 (quoting NAFTA Article 1113).

4 D. 4.2.

5 See D. 4.4.

II The dispute on the merits

Claimant Pac Rim Cayman LLC ("Pac Rim Cayman" or "Claimant") is a national of the United States, which is a contracting state to the Convention on the Settlement of Investment Disputes ("ICSID Convention") and CAFTA. D. 1.1; 1.3. Pac Rim Cayman is wholly owned by Pacific Rim Mining Corporation ("Pacific Rim Canada"), which is a Canadian corporation. Canada is not and has never been a contracting state to either CAFTA or the ICSID Convention. *Id.* at 1.3. The Respondent is the Republic of El Salvador ("El Salvador"). D. 1.5.

Claimant asserted, on the merits, that El Salvador engaged in unfair and inequitable treatment of Pac Rim Cayman by failing to act upon its application for a gold mining exploitation concession and environmental permits following a period of exploration in El Salvador. D. 1.8. In particular, Claimant asserted that El Salvador's conduct amounted to an unlawful expropriation of the investments of the Pac Rim family of companies in El Salvador. *Id.* Though there was some vagueness on this point in the Notice of Intent to Arbitrate and the Notice of Arbitration,[6] by the time of the jurisdictional phase of the arbitration, the measure complained of was a so-called "*de facto*" mining ban announced by President Saca in March, 2008. D. 2.55. It was the position of Pac Rim Cayman that El Salvador breached various sections of CAFTA[7] and several of its own state laws, including the Investment Law of El Salvador, by undertaking such acts. El Salvador denied all such claims.

III Jurisdictional objections

The Republic of El Salvador interposed four jurisdictional objections: (1) Abuse of Process by Claimant; (2) Ratione Temporis; (3) Denial of Benefits under CAFTA; and (4) objections under the Investment Law of El Salvador. D. 1.17. All objections were denied by the Tribunal, with the exception of the Denial of Benefits objection, which was sustained. The focus of this paper is the nature of that objection, the reasoning and holding of the Tribunal, and the implications of the Tribunal's holding on future investment relationships between States and investing parties.

IV The denial of benefits objection

The "denial of benefits" defense is treaty based. CAFTA Article 10.12.2 permits a CAFTA Party, such as El Salvador, to "deny the benefits of [Chapter 10 of CAFTA] to an investor" if certain conditions are met. D. 4.1 (quoting CAFTA Art. 10.12.2). Benefits under Chapter 10 of CAFTA include the provisions relating to "Investor-State Dispute Settlement" and, in particular, those set forth in CAFTA

6 See D. 2.53-54; D. 2.5.8.

7 Claimant asserted that El Salvador breached Articles 10.3 ("National Treatment"), 10.4 ("Most-Favored Nation Treatment"), 10.5 ("Minimum Standard Treatment"), 10.7 ("Expropriation and Compensation"), and 10.16.1(b)(i)(B) (regarding "investment authorizations"). D. 1.10. The text of these CAFTA provisions and the Investment Law of El Salvador can be found in the Annex to Part 1 of the Decision.

Article 10.16(3)(a), which provides for ICSID arbitration of any disputes under CAFTA. D. 4.4. Thus, a successful invocation of the defense results in a declaration that the ICSID Tribunal has no jurisdiction over the treaty dispute.[8] D. 4.4.

Under CAFTA, the denial of benefits is a two-part test. Benefits may be denied

> *to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party and persons of a non-Party, or of the denying Party, own or control the enterprise.*[9]

Put simply, this treaty language provides that a denial of benefits defense will prevail if the state party can show that Claimant a) has no "substantial business activities" in a signatory country (other than, of course, the Respondent country); *and* b) is "own[ed]" *or* "control[led]" by persons of a non-signatory country or by persons in the Respondent country. Note that while the test has two parts – a "substantial business activities" leg and an ownership/control leg – the second leg is disjunctive and therefore can be satisfied by showing either ownership or control by persons of a non-signatory country. D. 4.61.

A The evidence

1 Substantial business activities

El Salvador argued that, notwithstanding the fact that Claimant is a Nevada corporation, with its principal place of business in Nevada, it had no substantial business activities in the United States. D. 4.8; 4.10. Aside from documentary evidence in this regard, El Salvador elicited concessions at the hearing from the President and Chief Executive Officer of Pacific Rim Canada, Mr. Thomas C. Shrake, that the only activity of Claimant in the United States was to hold shares: it had no employees; it leased no office space; it had no bank account; it has no board of directors; it pays no taxes in the United States; it owns no tangible property or makes anything in the United States; and it performs no exploration activities from the United States. D. 4.8. Moreover, the alleged investments at issue in El Salvador were made not by the Claimant but by either Claimant's parent or another affiliated company. *Id.* El Salvador argued that if merely being a holding company were enough to constitute "substantial business activities," then the entire purpose of CAFTA Article 10.12.2 would be eviscerated, as all enterprises passively holding shares would qualify for CAFTA treaty protection. D. 4.9.

Claimant did not contest the facts set forth above. Rather, it urged the Tribunal to consider the "substantial business activities" question in light of the entire

8 In this respect, CAFTA denial of benefits provisions differ from those of Article 17(1) of the Energy Charter Treaty, where the dispute resolution provisions are in a section different from those relating to the benefits that may be denied. *See* D. 4.4; Energy Charter Treaty, Art. 17, 34 ILM 373 (1995) (http://www.encharter.org). Thus, an invocation of the denial of benefits defense under the Energy Charter Treaty, even if successful, will not deprive the Tribunal of jurisdiction.

9 CAFTA Article 10.12.2.

family of Pacific Rim companies, "which together contributed substantial financial capital, intellectual property, personnel and oversight to the companies' Salvadoran operations." D. 4.34.

2 Ownership/control

El Salvador asserted, and Claimant did not dispute, that at all relevant times Claimant was a wholly owned subsidiary of Pacific Rim Canada, a Canadian corporation, who is a "person of a non-Party" under the CAFTA treaty language. Claimant Pac Rim Cayman LLC's Countermemorial in Response to Respondent's Objections to Jurisdiction, ICSID Case No. ARB/09/12, para. 326 (December 31, 2010). El Salvador's position was that, based on this concession alone, the ownership or control test was satisfied in that the Claimant was both owned and controlled by a "person of a non-Party." D. 4.11-4.16.

In response, Claimant argued that the ownership analysis required a consideration of "ultimate[]" ownership, and that while it was true that Claimant was owned by a Canadian corporation, the shares of that corporation were publicly traded such that a majority of the shares of the Canadian parent were held by individuals with United States addresses. D. 4.35-4.37. Therefore, it follows that the Canadian parent is owned by persons of a CAFTA party (namely, the United States), and thus Claimant, as the Canadian parent's subsidiary, is also indirectly owned by persons of that same CAFTA party (the United States). D. 4.12; 4.35; 4.37. El Salvador responded that even if all of these facts as to "ultimate" ownership were assumed to be true, for the sake of argument, such facts still did not defeat the ownership defense because: a) the Claimant was still wholly owned by a "person of a non-Party," even if "ultimate" ownership was otherwise; and b) the mere fact that the shareholders had United States addresses did not make those shareholders "persons of a Party" under the treaty definition of such term, which, in the case of the United States, incorporated the definitions of the *Immigration and Nationality Act*. D. 4.14.

The evidence on "control" was interesting in that both Claimant and El Salvador relied upon the same facts, each party believing that those facts advanced their respective positions. Claimant elicited live testimony from Mr. Shrake, the CEO of Pacific Rim Canada, that he made all of the significant corporate decisions for the Claimant and Claimant's Cayman Islands predecessor corporation. *See* D. 4.71 (citing Hearing Transcript at 511-12). These decisions included asset sales, changes in corporate form, and the change of the corporate domicile from the Cayman Islands to the United States. *Id.* Claimant presumably elicited this testimony to argue that, because Mr. Shrake was also the President of yet another company in the Pacific Rim family, Pacific Rim Exploration, also a Nevada Corporation, these actions demonstrating "control" over Claimant were taken by Mr. Shrake in his capacity as President of a United States company. In short, Claimant urged that these facts showed control of Claimant by a CAFTA signatory.

El Salvador responded that this was precisely backwards, given the undisputed fact that Pacific Rim Exploration was a *subsidiary* of Claimant, not a *parent* of Claimant. *See* D. 2.16-20, 4.12. It was not possible as a matter of basic corporations law and practice for a subsidiary to "control" its parent, and the more logical conclusion from Mr. Shrake's testimony is that the control he exercised was in his capacity as President and CEO of Pacific Rim Canada, the ultimate parent

and indisputably a "person of a non-Party." Indeed, Mr. Shrake admitted under questioning from El Salvador that the Board of Directors of Pacific Rim Canada directs the Claimant and that Pacific Rim Canada controls all of its holding companies, operating companies, and local subsidiary companies, including Claimant. Hearing Trans. 492; 507; 514-16.

3 Timeliness

El Salvador asserted that it intended to and, in fact, did deny benefits to Claimant in a timely manner under CAFTA, in August 2010, and that it also timely provided prior notification to the United States, in March 2010. D. 4.17. El Salvador observed that nowhere does CAFTA impose a time limit for the invocation of the denial of benefits defense and that, in practice, the question of whether a State has the right to deny benefits to an investor is not likely to arise or be investigated before a dispute has arisen with that investor.[10] D. 4.18-19. El Salvador further submitted that denial of benefits is appropriate even where, as here, an ICSID arbitration had already commenced and that such invocation did not amount to a unilateral withdrawal of consent prohibited by Article 25(1) of the ICSID Convention.[11] D. 4.19. That is so because the general consent expressed in CAFTA Article 10.17 is not unconditional; rather, it is subject to all of CAFTA's provisions, including that an enterprise not fall within the terms of CAFTA Article 10.12.2. D. 4.19.[12]

Indeed, El Salvador noted that the facts of this case demonstrated the inappropriateness of requiring invocation of the defense prior to commencement of arbitration. The Claimant did not change its nationality from the Cayman Islands to the United States until long after the vast majority of the investments at issue had already been made, in December 2007, and El Salvador was not put on notice of this nationality change except by happenstance some months later, in June 2008. D. 4.22. Thus, El Salvador would not even have known of the United States nationality of Claimant (much less that such entity would attempt to be a claimant) until then. Indeed, El Salvador asserted that even the Notice of Intent to arbitrate was misleading in that it asserted (incorrectly) that Claimant was an "American investor," which was "predominantly managed and directed from its exploration headquarters in Reno, Nevada." D. 4.24. In short, El Salvador had only partially completed its investigations into Claimant's ownership and busi-

10 See supra note 2 at 1113-1, 1113-6, n. 33; Rachel Thorn/Jennifer Doucleff, Disregarding the Corporate Veil and Denial of Benefits Clauses: Testing Treaty Language and the Concept of 'Investor,' in: Michael Waibel et al. (eds.), The Backlash against Investment Arbitration, Alphen aan den Rijn 2010.

11 The Government of Costa Rica presented a submission to the same effect, noting that "denial of benefits may occur at any time, regardless even of the existence or not of an investment arbitration," particularly at the time when a Tribunal is examining its jurisdiction. D. 4.52.

12 In response to a question from the Tribunal, El Salvador did concede that, under principles of waiver and good faith, a CAFTA Party could not wait until after an adverse award to invoke the denial of benefits defense. D. 4.21. The Government of Costa Rica's submission concurred. D. 4.52. This point, however, did not enter into the Tribunal's decision, as invocation in this case was at a time when other jurisdictional objections were interposed.

ness activities by the time it provided notice to the United States of its intent to deny benefits in March 2010 so that it could be in a position to formally make such denial in August 2010. D. 4.25.

The Non-Disputing Party submissions of both the United States and the Government of Costa Rica spelled out the practical pitfalls of imposing an early deadline, unsupported by any treaty language, on the invocation of denial of benefits. The United States observed that imposition of such a deadline would result in undue burdens:

> It would require the respondent, in effect, to monitor the ever-changing business activities of all enterprises in the territories of each of the other six [CAFTA] Parties that attempt to make, are making, or have made investments in the territory of the respondent. … This would include conducting, on a continuing basis, factual research, for all such enterprises, on their respective corporate structures and the extent of their business activities in those countries. … Requiring [CAFTA] Parties to conduct this kind of continuous oversight in order to be able to invoke the denial of benefits provision … before a claim is submitted to arbitration would undermine the purpose of the provision.
>
> D. 4.56.

Similarly, Costa Rica observed:

> A State Party to [CAFTA] is not necessarily informed at all times of the share make-up and corporate structure of all investors from other Parties to the Treaty in its territory. What is more likely is that the State only becomes aware of who owns or controls a company at the time when there is a dispute, which escalates into an investment arbitration. Failing to allow the invocation of the denial of benefits clause even when an investment arbitration has already commenced deprives this provision of any effectiveness.
>
> D. 4.53.[13]

By contrast, Claimant asserted that the Government's invocation of denial of benefits was untimely, in that notification to the United States of its intent to deny benefits and the submission of the actual statement of denial of benefits were both delivered long after the commencement of the ICSID arbitration. D.4.38-39. Specifically, Claimant observed that invocation of denial of benefits was expressly made "subject to" compliance with two other CAFTA articles: the first on the provision of notice to other CAFTA Parties of measures that may affect CAFTA rights under Article 18.3; and the second relating to formal State-to-State consultations under CAFTA Article 20.4. D. 4.40. Therefore, because the denial of benefits is made "subject to" these obligations, compliance with them must necessarily precede the invocation of denial of benefits by a CAFTA party. D. 4.40.

13 Similarly, *Amicus Curiae* consisting of eight member organizations of La Mesa Frente a la Minería de El Salvador (The El Salvador National Roundtable on Mining) observed that imposing a time limit for the denial of benefits invocation "would necessarily be expensive" for a host state that could "be facing serious imperatives regarding poverty alleviation" and other goals. D. 4.59.

Moreover, Claimant urged that waiting until the arbitration had already commenced to invoke denial of benefits eviscerated the opportunity of the United States to engage in the "State-to-State consultations" contemplated by Article 20.4, because by then the United States was bound by its treaty obligation under ICSID Article 27(1) not to give diplomatic protection to Claimant. D. 4.45.

B The Tribunal's decision

After observing that the burden of proving the defense rested with the party raising it, *i.e.*, El Salvador, D. 2.11, 4.60, the Tribunal turned to each of the legs of the denial of benefits test.

1 Substantial business activities

The Tribunal began by acknowledging the evidence that the *group* of companies of which Claimant forms a part certainly has had "substantial business activities" in the United States during the relevant time period. D. 4.63-65. Indeed, the Government elected not to cross-examine Claimant's witness on these matters, so her testimony was received by an unchallenged declaration. D. 4.64. However, the Tribunal was quick to point out that the requirement of the first leg of CAFTA Article 10.12.2 relates to activities of the "enterprise" itself, namely Claimant. D. 4.66. The Tribunal concluded as a matter of treaty interpretation that Claimant could not rely upon activities of other affiliated entities to satisfy the "substantial business activities test":

> If that enterprise's own activities do not reach the level stipulated by CAFTA Article 10.12.2, it cannot aggregate to itself the separate activities of other natural or legal persons to increase the level of its own activities: those would not be the enterprise's activities for the purpose of applying CAFTA Article 10.12.2.
>
> D. 4.66.

Applying this test, the Tribunal had no difficulty concluding that Claimant had no "substantial business activities" in the United States. Rather, the Tribunal found that "Claimant was a passive actor both in the USA and the Cayman Islands both before and after December 2007, with no material change consequent upon its change of nationality." D. 4.68. The Tribunal relied heavily upon Mr. Shrake's oral testimony, which was said to "demonstrate[] the slender scale of the Claimant's activities." *See* D. 4.68-70. The Tribunal noted that there were activities in the United States, but those activities were "those of Pacific Rim Exploration Inc," the other Nevada corporation in the Pac Rim family of companies. D. 4.71. This was the entity that, according to Mr. Shrake, engaged in "mine-finding" and "wealth creation," was the source of the "intellectual property of the company," and "contributed everything to El Salvador." D. 4.71. The Tribunal concluded that "[t]his explanation significantly excluded the Claimant from the scope of such activities (not being involved with such intellectual property, in contrast to Pacific Rim Exploration Inc.)." *Id.*

Perhaps conscious of the implications of its decisions for future arbitrations, the Tribunal added that it was not deciding that a traditional holding company could never meet the "substantial business activities" requirement of CAFTA

Article 10.12.2. D. 4.72. Such traditional holding companies, according to the Tribunal, "will usually have a board of directors, board minutes, a continuous physical presence and a bank account." *Id.* None of these were found to be true in this case. *See* D. 4.73. Indeed, the Tribunal found it telling that none of the activities of Claimant appeared to change in any material respect upon its establishment as a United States corporation; rather, "the location (or non-location) of the Claimant's activities remained essentially the same notwithstanding the change in nationality; and such activities were equally insubstantial." *Id.* The Tribunal also noted that the conclusion might also have been different "if it was acting as a traditional holding company" holding shares in subsidiaries doing business in the United States, but this was not the case. D. 4.74.

2 Ownership/control

The Tribunal quickly dispensed with the ownership issue. It first noted the undisputed fact that Claimant has always been wholly owned by its Canadian parent company, a person of a non-CAFTA party. D. 4.79. The Tribunal next turned to Claimant's argument that the fact that a majority of the shareholders of the Canadian company have United States addresses should result in a conclusion that Claimant is owned, indirectly, by persons of a CAFTA Party (*i.e.*, the United States). D. 4.80. The Tribunal viewed the text of CAFTA dispositive. Under CAFTA's Annex 2.1, the definition of natural "persons" of the United States is nationals as set forth under the United States *Immigration and Nationality Act*. D. 4.81. However, under that Act, one cannot demonstrate one's status as a United States national merely by demonstrating a postal address in the United States. *Id.* Thus, even accepting Claimant's evidence that the majority of the shareholders of its parent had addresses in the United States, this fact was insufficient to demonstrate that a majority of the shareholders were United States "nationals" as defined by the statute and, by incorporation, the CAFTA treaty. D. 4.81. In short, the Tribunal also found the second leg of the denial of benefits test to be met and declined to reach the "control" issue as unnecessary given its holding on "ownership."[14] D. 4.82.

3 Timeliness

The Tribunal began by observing that there is no express time limit in CAFTA to assert a denial of benefits under CAFTA Article 10.12.2. D. 4.83. It noted that in a "different case" this issue might have caused the Tribunal "certain difficulties given the importance of investor-state arbitration generally and, in particular, the potential unfairness of a State deciding, as a judge in its own interest, to thwart such an arbitration after its commencement." *Id.* However, the Tribunal noted that no such difficulties were present in this case for three reasons.

First, the Tribunal acknowledged that, as the first instance of denial of benefits in any CAFTA case, this decision required particular attention and care. D. 4.84. Moreover, there was no indication that El Salvador attained any ad-

14 The Tribunal did note the following with respect to control: "It should not be assumed that the Respondent's case would have failed on this issue, if necessary to the Tribunal's decisions above." D. 4.82.

vantage with respect to the timing of its notice to the United States or invocation of the denial of benefits to Claimant. *Id.*

Second, noting that this was an arbitration under the ICSID Convention and the ICSID Arbitration Rules, the Tribunal observed that such Rules provide that objections to jurisdiction be made "no later than the expiration of the time fixed for the filing of the counter-memorial," which time period was here respected. D. 4.85. In reaching this conclusion, the Tribunal acknowledged the practical difficulties of requiring any earlier deadline, as set forth in the submissions of Costa Rica, the United States, and the *Amicus Curiae*. *Id.*

Third, the Tribunal rejected Claimant's argument that the procedures envisaged by CAFTA Articles 20.4 or 18.3 amount to the exercise of diplomatic protection by a CAFTA party. D. 4.87-89. And finally, the Tribunal agreed with the Government that the denial of benefits was not an impermissible unilateral withdrawal of consent to arbitration because such consent "is necessarily qualified from the outset by CAFTA Article 10.12.2." D. 4.90.

Based on these conclusions, the Tribunal had no choice but to decide that El Salvador had satisfied its burden of proof, as a matter of fact and international law, and that Claimant, an investor and its investments in El Salvador, could receive no benefits from Part 10 of CAFTA, upon which Claimant's CAFTA claims necessarily depended. D. 4.92. Accordingly, the Tribunal held that it had no jurisdiction with respect to any such CAFTA claims, dismissing them in their entirety.[15] *Id.*

V Lessons to be learned

The *Pac Rim* denial of benefits decision has important implications both for investors and host states. Some lessons to be learned are outlined below.

A For investors

1) *Carefully pick your Claimant.* With modern corporate conglomerates having numerous affiliated companies, it is often the case that an aggrieved investor will have more than one corporate entity involved with the respondent government relationship. One entity may have supplied the funds, another may have operated the investment, and still another may have engaged in the formal contracting and permitting process with the host state. The *Pac Rim* case was no exception, with various corporate entities involved in different aspects of the project.

   What is interesting is that in *Pac Rim* there was another United States entity, Pacific Rim Exploration Inc., who arguably *did* have "substantial business activities" with the United States, and thus could have satisfied the first leg of the denial of benefits test. For whatever reason (likely tax driven), Pac Rim did not choose that entity to be Claimant, with dire consequences. It is important that investors carefully examine all of the options with respect to naming an appropriate claimant, as the failure to pick correctly may result in dismissal on jurisdictional grounds.

15 As noted earlier, other, non-CAFTA claims were not impacted by the denial of benefits analysis and were permitted to proceed to the next stage of the arbitration.

2) *Formalities matter.* The reasoning of the *Pac Rim* Tribunal illustrates that formalities do matter. Even if the chosen claimant is a "mere" traditional holding company, steps should be taken to ensure that such holding company has a board of directors, keeps minutes, a physical presence in the territory of the party (*i.e.*, at least a small office in its name), and a bank account. The Tribunal relied on the absence of all of these factors in finding that Claimant had no "substantial business activities" in the United States. And if the entity chosen to be the claimant is a holding company, it should hold at least one company that has activities in the state at issue (not vice-versa, as in *Pac Rim*, where the United States operating company held Claimant).
3) *Choose the home of your intellectual property with care.* The Tribunal noted that none of the relevant intellectual property was owned by Claimant but, rather, was owned by another United States entity. The ownership of intellectual property, of course, is a matter that can be changed with appropriate licenses, assignments, and the like. Any investment in a host state should be accompanied by an intellectual property review to make sure that the intellectual property resides in the right hands so that the claimant chosen can be said to have contributed such property to the endeavor.

B For host states

1) *Begin the denial of benefits analysis at the earliest possible time.* Although the *Pac Rim* Tribunal concluded that the invocation of denial of benefits was in that case timely, there is much to be done in a relatively short period of time to interpose a successful denial of benefits defense. Once a dispute has arisen (or seems likely), a host state would be well advised to investigate the nationalities and corporate relationships of all entities involved in the investor relationship. Some leg work up front can yield great benefits in any subsequent arbitration.
2) *Reject unknown interloper entities.* While an investor may have an interest in involving a corporate entity that is a "person of a Party" to establish CAFTA jurisdiction, the host state should reject any transparent attempts, during the investment relationship, by the investor family of companies to involve such entities if there is no apparent legitimate purpose for doing so.
3) *Formalities matter.* For the same reason that formalities matter with investors, they matter with host states as well. Host states should be attuned to the subtleties of the paper trail associated with the investment relationship. With respect to conglomerate corporate investors with lots of affiliated companies, which company is wiring the investment funds? Which company is signing the contracts, executing the leases, or paying the workers? And if the answer is multiple companies, the host state is entitled to, and should receive, an explanation for why the relationship is structured the way it is.
   The first denial of benefits decision under CAFTA teaches these and other lessons, which should prepare parties on both sides of the bargaining table for potential disputes down the road.