Makae Europe SARL v Kingdom of Saudi Arabia: Insufficient control of retail operations bars investment treaty claim

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Introduction

In its first win at the International Centre for Settlement of Investment Disputes (ICSID), Saudi Arabia recently secured the dismissal of a US$570 million investment treaty claim by a French fashion and restaurant chain on jurisdictional grounds. The ICSID Award holds lessons for foreign parent companies who wish to enjoy the benefit of investment treaty protection in respect of their businesses in Saudi Arabia and throughout the GCC. In this article, we review the parties' arguments and the Tribunal's findings on the issues of what constitutes a qualifying investor and a protected investment under the bilateral investment treaty ("BIT") between France and Saudi Arabia in the context of a multi-brand retail chain that was closed down by the Saudi authorities over twenty years ago.

Factual Background

The Claimant, a French company, claimed for loss and damage resulting from the alleged expropriation of what it asserted was an extensive retail and restaurant business in Saudi Arabia that brought "popular international brands to consumers in the Kingdom," as a result of the closure of its stores and restaurants in August 2001 by representatives of the Respondent's Ministry of Commerce and Industry.

Jurisdictional Challenge

The Respondent asserted that the Tribunal lacked jurisdiction to hear the Claimant's case on the basis that the Claimant (1) could not be considered as a protected investor under the BIT and (2) did not exercise the required degree of influence and control of its investment for the investment to be protected under the BIT.

The Respondent's Arguments

The Claimant was not an investor under the BIT

The Respondent submitted that the Claimant did not qualify as an investor for purposes of the BIT for two reasons. First, it contended that the Claimant was not constituted in conformity with French law and was in fact a "fictitious" company as that concept is known in French law.

Secondly, the Respondent contended that the Claimant did not have a head office in France to fulfil requirements of a legal entity in the country. The Respondent thus argued that the Claimant was not constituted in accordance with French law. The Respondent emphasized three factors in this regard:

- the absence of *affectio societatis*, that is, the legally required intention of the Claimant's incorporators to "become partners and behave as such";
- the "absence of any corporate life" evidenced by failure to convene shareholders' meetings and to prepare and file required annual accounts; and
- "the absence of a common enterprise," contending that the Claimant's evidence did not prove that it actually carried on real economic activity.

The Claimant did not own or control an investment protected under the BIT

In addition to denying that the Claimant was a qualifying investor under the BIT, the Respondent maintained that there was no covered investment. First, it contended that the Claimant did not own or control an investment in Saudi Arabia.

Second, it asserted that if the Claimant owned or controlled an investment in Saudi Arabia, its control would have been a violation of Saudi law since non-GCC nationals, such as the Claimant, could not take 100% control of the investments.

Third, the Respondent contended that control as claimed by the Claimant could not be proved by testimonial evidence alone but must also be confirmed by contemporaneous documentary evidence or evidence of other form of economic activity in the investment

Claimant's Arguments

The Claimant was an investor under the BIT

The Claimant argued that because it was a French SARL (*Societe a Responsabilite Limitee*) that was legally constituted as a matter of French law when its articles of association were signed, it was entitled to protection as an investor under the BIT.

The Claimant did exercise control over an investment such as to ensure its protection under the BIT

The Claimant submitted that in the restaurant and retail businesses, brand and product acquisition strategies play a crucial role and are the central drivers of a business's activities and value. Control over these matters therefore entails control of the business, although such control may be indirect and perhaps not exclusive. The fact that other entities in a corporate family may carry out operational functions does not alter the central importance of brand and product selection in controlling the corporate family's fortunes.

The Claimant emphasized the critical role of brand acquisition and product selection in the investment's retail apparel and restaurant businesses in Saudi Arabia. For the Claimant, in the fashion retail and restaurant industries, *de facto* control manifests in control over the

brand and product acquisition strategies. In this regard, the Claimant drew attention to several major international concerns in consumer, fashion and luxury goods businesses in which a small entity within a much larger corporate family fundamentally shapes the definition, direction, and activities of the larger family by identifying suppliers or goods, identifying rapidly evolving customer tastes, or by themselves designing products that lead or respond to developing tastes and trends.

The Claimant contended that its role in identifying the brands and products to be offered to customers in Saudi Arabia gave it *de facto* control of the investment. It thus argued that there could be *de facto* control where the evidence established that a small and specialized component of a corporate family performs a role or roles that determine the overall character and direction of an enterprise.

Furthermore, the Claimant alleged that its investment in Saudi Arabia was part of a network of similar retail and restaurant establishments in several Gulf States. According to the Claimant, through its local Saudi affiliate, the Claimant secured the necessary approvals to operate its outlets in cities across the Kingdom, signed leases with malls for brand-focused stores that would attract and retain customers, and opened dozens of stores.

Tribunal's analysis

The Tribunal determined that it must decide whether it had jurisdiction under the BIT to proceed to the merits of the Claimant's claims. There could only be jurisdiction if the claims fell within the limits of the Respondent's consent to jurisdiction reflected in [Article 1 of the BIT]. Hence, there must be a qualifying investor; there must be a covered investment; and the investment must be owned or controlled by the investor. Such ownership or control must also be in conformity with the Respondent's legislation. If any of these requirements were not met, the claim would not be within the scope of the Respondent's consent to jurisdiction, and the Tribunal could not proceed**.**

Whether the Claimant was an investor under the BIT

A decision by the Tribunal accepting any one of the Respondent's several objections to jurisdiction meant that the case could not go forward. Such a decision also made it unnecessary for the Tribunal to decide on other disputed jurisdictional issues. In the interests of judicial economy, the Tribunal chose to address first the Respondent's objection that the Claimant did not control the investment. Hence, in upholding the Respondent's objection in this regard, the Tribunal did not need to determine this other jurisdictional issue.

The Claimant did not control the investment

The Tribunal held that in order for the Claimant's investment to attract protection under the BIT, it had to satisfy three requirements: (1) there must be a covered investment, (2) the investment must be owned or controlled by the investor and (3) such ownership or control must be in conformity with the Respondent's legislation. If any of these requirements was not met, the claim would not be within the scope of the Respondent's consent to jurisdiction, the Tribunal could not proceed further, and the claim would be dismissed. The Tribunal concluded that the evidence did not establish that the Claimant exercised *de facto* control over the investment at any relevant time.

The Tribunal did not accept the Respondent's contention that proof of *de facto* control requires a Claimant to demonstrate some ownership or other form of economic interest in an investment. The BIT established ownership or control as alternative bases of jurisdiction. The contention that control requires ownership or other form of economic interest would disregard this distinction, and conflicts with the ordinary meaning of the Treaty's text. The Tribunal accepted that the conception of control advanced by the Claimant, while unusual in the context of international investment law, did correspond to some of the ordinary dictionary meanings of "control" advanced by the parties.

The Tribunal found that there could be *de facto* control where the evidence established that a small and specialized component of a corporate family performed a role or roles that determined the overall character and direction of an enterprise. However, it found it difficult to reconcile the Claimant's contention that it exercised *de facto* control over the investments in Saudi Arabia. The Tribunal found that even though the Claimant's management may have had significant plans and ambitions for the Claimant's future, it was never more than a small component in its larger group of companies to constitute *de facto* control.

The Tribunal noted that not only did the Claimant lease a small pre-furnished office for its "operations" in France, the company employed just two employees, a significantly small number for the alleged "nerve center" of an extensive retail and restaurant businesses in Saudi Arabia and throughout the Gulf capable of giving the Claimant’s international European and US partners the “critical level of comfort” necessary to do business with it.

During its roughly two-and-a-half years of operation in France, the Claimant was, at best, in a nascent state. The evidence indicated that during that period while the Claimant had a physical presence in France, its activities were modest and limited in scope and it did not take over significant roles in developing and managing relationships with premium brands or in determining brands and products for sale. The Tribunal concluded that the evidence did not establish that the Claimant exercised *de facto* control over the investment at any relevant time.

The Tribunal found that there was no evidence that the Claimant’s branding and strategic decision-making was being organized or would occur at any future time. Nor was there evidence confirming that the Claimant continued to control the investment until it was completely destroyed, by the end of 2005 or continued negotiating new opportunities with investors in Saudi Arabia.

The Tribunal’s decision that the Claimant did not prove that it controlled the claimed investment meant that the Tribunal lacked jurisdiction and that the claim had to be dismissed.

Conclusion

As this case demonstrates, it is imperative for a claimant to demonstrate at a jurisdictional stage both that it is a protected investor and that it exercises a minimum level of control over its investment in order for its investment to enjoy investment treaty protection. This case should encourage foreign parents outside the GCC to review their arrangements in respect of their investments in the GCC, including in the retail sector, to ensure they qualify for investment treaty protection, where available.

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