

INVESTMENT TREATY PLANNING SHOULD BE ON THE CHECKLIST FOR EVERY FOREIGN INVESTMENT YOUR COMPANY MAKES

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The title of this article explains why we have written it. Investment treaty planning may ultimately play no role in the way your company structures a foreign investment. At the very least, however, it should be on the checklist of items to consider as a foreign investment is being structured. Because, in our experience, there are so many companies that make foreign investments and give little or no consideration to investment treaty planning, this primer on the basics of investment treaty protections should help you decide whether this is an issue to which your company should be paying greater attention when it makes its next foreign investment.

Every sophisticated international investor invariably obtains advice as to how to structure its investment to take advantage of international tax treaties. Investment treaties are not nearly as well-known among investors, but can play an important role in the life of an investment. These treaties offer foreign investors and their investments certain legal guarantees from the host country government, as well as the ability to seek compensation through international arbitration if these guarantees are breached.

If an investment is structured to gain the protection of an investment treaty, an investor can recover damages if its investment is lost or impaired due to discriminatory or arbitrary government action. As importantly, the existence of investment treaties may deter host state governments from taking such actions in the first place. Looked at another way, all else being equal, a foreign investment structured in a way that gives the investor the possibility of taking advantage of an investment treaty, compared to one that does not, can mean the difference between having recourse in the event a host government acts against you, as compared to possibly having to write off your investment.

Put simply, investment treaty planning is a form of political risk insurance that all international investors should be familiar with and consider alongside tax treaties when structuring their investments.

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I. INTRODUCTION TO INVESTMENT TREATIES

As any foreign investor knows, governmental interference with foreign investment is a worry in many countries. As examples, in the past 20 years, governments around the world have targeted foreign investors due to an economic crisis (*see* Argentina in the early 2000's), a policy shift to the more socialist (*see* Venezuela in the mid-2000's to the present), and nationalism (*see* Hungary in the past few years.).

Investment treaties are intended to promote foreign investment by giving investors confidence that their investments will not be targeted, or at least that they will be compensated if such actions are taken. Most investment treaties are bilateral (BITs), meaning made between just two countries. Investment protection provisions can also be included in larger, multilateral trade treaties among multiple countries. There is an immense network of over 3,000 BITs in force today, to which more than 170 countries are parties.³ In addition, a number of multilateral trade treaties include provisions that protect investors, such as NAFTA, the Energy Charter Treaty, ASEAN, and—if it is finally approved—CETA between Canada, the EU, and its member states.⁴

Well over 600 arbitrations have been brought by foreign investors under investment treaties.⁵ Most investment arbitrations are administered by, and under the rules of, the World Bank's International Center for the Settlement of Investment Disputes (ICSID), an international organization with 162 members.⁶ Importantly, all ICSID members have agreed to enforce awards rendered by an ICSID arbitration tribunal in the same manner that they would enforce their own court judgments, making an ICSID award easier to enforce than a foreign judgment or even a non-ICSID arbitration award.

The government actions for which investors have been awarded compensation ranges from outright expropriation of an investment,⁷ to changes in laws that make it harder for the investment to be profitable,⁸ to arbitrary administrative decisions that prevent an

³ See Grant Hanessian, Edward E. Poulton, Kabir A.N. Duggal, *Investor-State Arbitration* in INTERNATIONAL ARBITRATION CHECKLIST (Juris 2016), p. 273.

⁴ A database of investment treaties, available by country, is kept by United Nations Conference on Trade and Development (UNCTAD), available at <http://investmentpolicyhub.unctad.org/IIA>.

⁵ *Special Update on Investor-State Dispute Settlement: Facts and Figures*, UNCTAD, November 2017, http://unctad.org/en/PublicationsLibrary/diaepcb2017d7_en.pdf.

⁶ *List of Contracting States and other Signatories of the Convention*, ICSID, Jan. 11, 2018, <https://icsid.worldbank.org/en/Documents/icsiddocs/List%20of%20Contracting%20States%20and%20Other%20Signatories%20of%20the%20Convention%20-%20Latest.pdf>.

⁷ See, e.g., *Gemplus, S.A., SLP, S.A. and Gemplus Industrial, S.A. de C.V. v. United Mexican States*, ICSID Case No. ARB(AF)/04/3 & ARB(AF)/04/4, Award, ¶¶ 8-27 (2010), available at <https://www.italaw.com/sites/default/files/case-documents/ita0357.pdf> (“The Tribunal decides, on the facts found above by the Tribunal in Parts IV and VII of this Award, that the Claimants’ investments were unlawfully expropriated by the Respondent, indirectly with the Requisition on 25 June 2001 and directly with the Revocation on 13 December 2002, in violation of Article 5 (1) of the Argentina BIT and Article 5 (1) of the France BIT respectively.”).

⁸ See, e.g., *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2, Award, ¶ 708 (2016), available at <https://www.italaw.com/sites/default/files/case-documents/italaw7194.pdf> (“the conjunction and progression of acts performed by different governmental organs, starting from the actions surrounding the denial of the Permit, continuing with the announcements

investment from operating,⁹ to breaches of concession agreements or other contracts with the host government.¹⁰ The amount of compensation awarded can be very substantial: in 2014, investors in the Russian company Yukos were awarded \$50 billion for the expropriation of their ownership stake.¹¹

Most investment treaties are very similar to one another. As set forth in the following sections, generally, they protect the same kinds of investments and the same kinds of investors, include the same general types of substantive guarantees by the host countries, and offer similar options to investors to seek redress. However, there are some important differences in the language of certain treaties that limit, or expand, their usefulness. It is therefore important, when structuring an investment, to carefully study available investment treaties, as well as subsequent case law that may inform their interpretation.

II. INVESTMENTS THAT CAN BE PROTECTED

Typically, investment treaties include a broad definition of assets that are subject to protection, supplemented by examples of specific types of assets that are explicitly included.

As a typical example, the Netherlands-South Korea BIT states that investment means “every kind of asset owned or controlled, directly or indirectly, by an investor”, including but not limited to:

- a) movable and immovable property and any other property rights such as mortgages, liens, leases or pledges;
- b) shares in, stocks and debentures of, and any other form of participation in a company or any business enterprise and rights or interest derived therefrom;
- c) claims to money or to any performance under contract having an economic value;

that Venezuela would “take back” Las Cristinas, and ending with the repudiation of the MOC, had the effect of substantially depriving Crystallex of the economic use and enjoyment of its investment, and ultimately rendered it entirely useless. The Tribunal thus concludes that the cumulative and incremental effect of those measures was ‘equivalent to [. . .] expropriation’ under Article VII(1) of the Treaty.”).

⁹ See, e.g., *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, ¶ 455 (2012), available at <https://www.italaw.com/sites/default/files/case-documents/italaw1094.pdf> (“the Tribunal now has no hesitation in finding that, in the particular circumstances of this case which it has traversed earlier, the taking by the Respondent of the Claimants’ investment by means of this administrative sanction was a measure “tantamount to expropriation” and thus in breach of Article III.1 of the Treaty.”).

¹⁰ See, e.g., *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v. Argentine Republic*, ICSID Case No. ARB/03/23, Award, ¶ 939 (2012), available at <https://www.italaw.com/sites/default/files/case-documents/ita1069.pdf> (“Concession agreements granted to foreign investors for specific investments, such as those at issue in this arbitration, fall within the protection of an —umbrella clause.”).

¹¹ Stanley Reed, *\$50 Billion Awarded in Breakup of Yukos*, NEW YORK TIMES, July 28, 2014, <https://www.nytimes.com/2014/07/29/business/international/yukos-shareholders-awarded-about-50-billion-in-court-ruling.html>. However, this award was annulled by a court in the Hague, although enforcement is being sought elsewhere. <https://www.lexology.com/library/detail.aspx?g=77aa8338-cb37-4357-81d0-f118dd94531f>.

- d) intellectual property rights including rights with respect to copyrights, patents, trademarks, trade names, industrial designs, technical processes, know-how, and goodwill;
- e) concessions having an economic value conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.¹²

Among the types of investments that have been the subject of investment treaty arbitrations are hedging agreements,¹³ loans,¹⁴ development projects,¹⁵ construction projects,¹⁶ manufacturing plants,¹⁷ and mining and exploration projects.¹⁸

Although the definition of “investment” is typically broad, one-off commercial transactions, such as sales contracts, do not typically qualify.

III. INVESTORS THAT CAN BE PROTECTED

Most BITs afford protections by the host country to all investors from the other country. In the case of individuals, the determination of who is “from” that country is most often straightforward, and means anyone who holds citizenship of that country.

With respect to corporations and other business entities, however, the issue can be more complicated, and varies somewhat from treaty to treaty:

¹² See Agreement on the Promotion and Protection of Investments between the Government of the Kingdom of the Netherlands and the Government of the Republic of Korea, signed July 12, 2003, Article 1(1) available at, <http://investmentpolicyhub.unctad.org/Download/TreatyFile/3256>.

¹³ See, e.g., *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/09/2, Award, ¶ 285 (2012), available at <https://www.italaw.com/sites/default/files/case-documents/italaw1272.pdf> (“The Arbitral Tribunal considers that the Hedging Agreement is an asset. It is a legal property with an economic value for Deutsche Bank. It is a claim to money which has been used to create an economic value.”).

¹⁴ See, e.g., *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, ¶ 214 (2007), available at <https://www.italaw.com/sites/default/files/case-documents/ita0770.pdf> (“Under the broad definition of investment contained in the Treaty, loans are generally to be considered as a protected investment.”).

¹⁵ See, e.g., *Marion Unglaube v. Republic of Costa Rica*, ICSID Case No. ARB/08/1, Award, (2012), available at <https://www.italaw.com/sites/default/files/case-documents/ita1052.pdf> (dealing with land development projects).

¹⁶ See, e.g., *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, ICSID Case No. ARB/14/3, Award, ¶ 263 (2016), available at <https://www.italaw.com/sites/default/files/case-documents/italaw8967.pdf> (“once an active process of construction of an energy project involving substantial resources is commenced, the merely preparatory phase is over and the project qualifies as an investment.”).

¹⁷ See, e.g., *American Manufacturing & Trading, Inc. v. Democratic Republic of the Congo*, ICSID Case No. ARB/93/1, Award, (1997), available at <https://www.italaw.com/sites/default/files/case-documents/ita0028.pdf>.

¹⁸ See, e.g., *Vannessa Ventures Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/04/6, Award, (2013), available at <https://www.italaw.com/sites/default/files/case-documents/italaw1250.pdf> (dealing with the exploitation of the Las Cristinas mine in Venezuela).

First, generally, a business entity is considered to have the nationality of its place of incorporation. However, to exclude “mailbox” companies, a minority of investment treaties require that the investor actually have substantial business operations in a country to be considered an “investor” from that country.¹⁹

Second, in many BITs, a subsidiary of a protected investor incorporated in the host state to carry out the investment is itself considered a protected investor, allowing both the parent and subsidiary to bring claims.

Third, once the nationality of a company is established, tribunals do not generally look to the ultimate beneficial owners of that company to determine whether it is an investor. As such, for example, a Lithuanian corporation was able to use an investment treaty between Ukraine and Lithuania even though its shareholders were in fact Ukrainian.²⁰ However, a minority of investment treaties include language that “pierce the veil” to include only business entities that are ultimately owned by investors of the other state.²¹

Fourth, investment arbitration tribunals have generally allowed indirect investments to be protected, unless such indirect investments are excluded in the language of the underlying treaty. Thus, for example, if a U.S. company founds a Netherlands B.V., which in turn invests in a Croatian manufacturing facility that is expropriated, the U.S. company could bring a claim under the U.S.-Croatia BIT, and/or the Dutch company could bring a claim under the Netherlands-Croatia BIT. However, certain tribunals have noted that there may be some limit to how indirect a claim can be.²²

Finally, the relevant nationality must be in place at the time of the alleged wrongdoing by the government. Thus, if there is a company that is not of a nationality that can benefit from a BIT and is concerned about actions that the host government might be about to take, it may be able restructure itself so as to come under a BIT prior to the actions taken by the government. However, if such a restructuring is done after such an action is taken, or announced, it is likely that a tribunal would not hear the case.²³

¹⁹ See, e.g., The Dominican Republic-Central America FTA (CAFTA-DR), Art. 10.12(2), available at https://ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf.

²⁰ See *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, Section IV(A) (2004), available at <https://www.italaw.com/sites/default/files/case-documents/ita0863.pdf>.

²¹ This is usually accomplished through a “denial of benefits” clause, which allows the host country to decide to deny treaty rights to an investor that is ultimately owned by investors of a third-party (see, e.g., Treaty between the United States of America and the Republic of Panama Concerning the Treatment and Protection of Investment, signed October 27, 1982, Article I(b)(ii), available at <https://www.state.gov/documents/organization/210527.pdf>).

²² See, e.g., *Enron Corp. and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, ¶ 52 (2004), available at <https://www.italaw.com/documents/Enron-Jurisdiction.pdf> (“The Tribunal notes that while investors can claim in their own right under the provisions of the treaty, there is indeed a need to establish a cut-off point beyond which claims would not be permissible as they would have only a remote connection to the affected company.”).

²³ See, e.g., *Mobil Corp, Venezuela Holdings B.V. v. Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, ¶¶ 203-206 (2010), available at <https://www.italaw.com/sites/default/files/case-documents/ita0538.pdf>; *Phoenix Action v. Czech Republic*, ICSID Case No. ARB/06/05, Award, ¶¶ 142-144 (2009), available at <https://www.italaw.com/sites/default/files/case-documents/ita0668.pdf>.

IV. TYPES OF PROTECTION GUARANTEED BY HOST COUNTRIES

The types of protection provided to investors will depend on the specific terms of each treaty and can vary among BITs. However, certain forms of protection are common.

First, investment treaties invariably require compensation to be paid in the event an investment is expropriated. This covers direct expropriation as well as “measures tantamount to expropriation” (indirect expropriation), which may involve a taking through governmental conduct that, in the aggregate, deprives a foreign investor of its property rights, control, or the value of its investment, even when the beneficial title remains with the investor. For example, an American investor who had purchased a Mexican landfill was granted compensation for an indirect expropriation when the local government refused to grant permits necessary to continue to operate the landfill, rendering the investment worthless, even though the investor still owned the underlying land.²⁴

Second, investment treaties typically include provisions calling for “fair and equitable treatment” (FET) and, in fact, that is the standard most frequently invoked by foreign investors in their claims. It remains difficult to articulate a strict definition for this standard because it is invariably specific to the facts of the particular case.

In general terms, however, tribunals have ruled that, under this standard, host States have an obligation to treat foreign investments in a manner that is just, non-discriminatory and conducive to fostering the promotion of foreign investment.

Applying this standard, tribunals have held that the host State has an obligation to comply with the “legitimate expectations” generated as a result of the investor’s dealings with the competent authorities of the host State. Thus, for example, if a host state law guarantees certain benefits to encourage investment, and then later refuses to award such a benefit to an investment, a breach of the obligation to provide FET may be found. This was the case where Romanian legislation promised substantial tax incentives for investments in an economically disadvantaged region. An investor built a number of food processing facilities in the region, but Romania discontinued the incentives after only five years. The investor was awarded \$100 million for benefits lost due to this change.²⁵

Third, most BITs include a “national treatment” standard, under which the host country must treat foreign investments no less favorably than similar investments of its own nationals and companies. For example, an investment dispute tribunal found that a foreign investor in Poland was discriminated against by quotas set on the sale of isoglucose made from wheat (manufactured by the investor) that were lower than those placed on

²⁴ See *Metalclad Corporation v. Mexico*, ICSID Case No. ARB(AF)/91/1, Award, ¶¶ 102-112 (2000), available at <https://www.italaw.com/sites/default/files/case-documents/ita0510.pdf>.

²⁵ See *Micula v. Romania*, ICSID Case No. ARB/05/20, Final Award, ¶ 1329 (2013), available at <https://www.italaw.com/sites/default/files/case-documents/italaw3036.pdf>.

sugar from made from beets (manufactured by domestic competitors).²⁶ Relatedly, "most favored nation" clauses ensure that foreign investors and their investments are treated comparably to investors from third states.

Fourth, most BITs include an "umbrella clause" in which the host state is required to honor any explicit obligations it entered into with the foreign investor.

Finally, there are other protections, although they rarely if ever have led to investment treaty claims. For example, nearly all BITs specify that a foreign investor can transfer funds related to its investment from the host State without delay, in a freely convertible currency, at the market rate of exchange. And many BITs require access to justice in national courts, allowing for a "denial of justice" claim if the local judiciary is exceptionally biased or inept.²⁷

V. RESORT TO ARBITRATION

An essential feature of investment treaties is that claims for breaches of the guarantees offered by the host government are decided in arbitration. Without such a provision, investors would be forced to make its claims before the courts of the host country, a proposition that often has little hope of success.

In many BITs, the investor is first obliged to give official notice to the host government that it believes the BIT was breached. Then, after a "cooling off period" of three to six months during which the investor and host government may negotiate to end the dispute, an arbitration can be commenced.²⁸

There are two exceptions present in some treaties. First, certain treaties include so-called "fork-in-the-road" provisions, that preclude an investor from bringing an arbitration if it has already tried to litigate the dispute in the courts of the host state.²⁹ On the other hand, a limited number of treaties require that an investor completely exhaust the opportunities to bring its claim before the court of a host country prior to starting an arbitration.³⁰

As noted above, ICSID is the most common forum for arbitrating investment disputes. ICSID arbitration is available if called for in the BIT, and if the country of the investor

²⁶ See *Cargill v. Poland*, ICSID Case No. ARB(AF)/04/2, Award (2008), available at <https://www.italaw.com/sites/default/files/case-documents/italaw9275.pdf>.

²⁷ See, e.g., *Dan Cake v. Hungary*, ICSID Case No. ARB/12/9, Decision on Jurisdiction and Liability (2015), available at, <https://www.italaw.com/sites/default/files/case-documents/italaw4457.pdf>.

²⁸ See, e.g., Treaty between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment, signed August 27, 1993, Article VI, available at <https://www.state.gov/documents/organization/43558.pdf>.

²⁹ See, e.g., Treaty between the French Republic and the Argentine Republic Concerning the Encouragement and Reciprocal Protection of Investment, signed July 3, 1991, Article 8(2), available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/55>.

³⁰ See, e.g., Agreement on Economic Cooperation between the Government of the Kingdom of Netherlands and the Government of the Republic of Singapore BIT, Article XI, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2079>.

and the host country are amongst the 162 signatories to the ICSID Convention. Some BITs also allow for ad-hoc arbitration under the UNCITRAL Rules, or at well-known international arbitration institutions such as the International Chamber of Commerce (ICC) or Stockholm Chamber of Commerce (SCC).

Investor state arbitration generally proceeds as any large-scale commercial arbitration, with each party appointing one arbitrator, and those arbitrators agreeing on a President of the Tribunal, or if they cannot agree, with the President being appointed by the relevant arbitral institution. The parties then proceed based on an agreed timetable, or one set forth by the Tribunal, that generally includes the submission of legal memorials, witness statements and exhibits in support of each parties' case; limited (compared to U.S. litigation) document discovery, and hearings most usually held in Washington, D.C.

However, there are some important differences between investor-state arbitration and commercial arbitration. As an initial matter, investor-state arbitrations are not based on any national law, but, rather, on the investment treaties themselves, supplemented by rules of international law. Because most investor-state arbitration awards are made public, such awards have become a useful source of law for subsequent investment treaty tribunals. Thus, while earlier awards are not binding precedent, they provide guidance as to the likely determination of later investor-state disputes.

For a similar reason, the jurisdiction of the tribunal is more often contested in investor-state disputes, and many disputes are therefore "bifurcated", with an initial phase of submissions and hearings dedicated solely on determining whether jurisdiction exists, with a second phase dealing with the merits of the dispute if the Tribunal finds it does have jurisdiction. This can mean that investor-state arbitrations can take longer to resolve than commercial arbitrations.

In addition, in the case of ICSID Proceedings, there is a quasi-appeal process known as "annulment" proceedings, in which either party can ask a committee of three new arbitrators to annul an award on the grounds that the tribunal was not properly constituted, was corrupt, did not provide due process, did not give reasons for its decision, or manifestly exceeded its powers.³¹

Finally, the filing of most investor-state arbitrations are, or become, public knowledge, and in many cases any awards and pleadings of the parties are released into the public domain.

VI. CONCLUSION

While tax planning, and in particular international tax treaties, should likely remain paramount in deciding how to structure a foreign investment, investors should also consider how to best take advantage of international investment treaties.

³¹ See Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Arts. 50-52, available at https://icsid.worldbank.org/en/Documents/resources/2006%20CRR_English-final.pdf.

Such planning is not only important when investing in a country that may foreseeably change its policies toward foreign investors, but also when the success of the investment is dependent on government regulations, permits or incentives; or when entering into a concession agreement with a host state.

To illustrate, a company is planning on making an investment in a host country. It has the possibility of structuring that foreign investment by using a special purpose vehicle incorporated in Country X or Country Y. Country X has an investment treaty with the host country and Country Y has no such treaty. All else being equal, or subject to being made equal, the choice between X and Y can be the difference between losing an investment and having an avenue to pursue arbitration against the host country in the event that the host government takes improper steps against the foreign investor.

Experienced external counsel should be able to guide investors to a structure which both minimizes tax obligations using international tax treaties, and maximizes investment treaty protection.

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For more than 35 years, Baker & McKenzie has been involved in arbitrations against governments and we also have experience in defending governments in ICSID cases. We also regularly counsel our clients on investment treaty planning. If you are interested, we would be happy to conduct a complimentary, in-house CLE program on the subject of investment treaty planning.