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Investment Treaty Considerations For Deal Makers

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Cyrus Benson   Penny Madden   Nicholas Tomlinson

If you are contemplating entering into investments in foreign markets, early consideration of protections available under bilateral investment treaties (BITs) and multilateral investment treaties (MITs) is crucial.

When Should You Be Considering BITs and MITs?

BITs and MITs protection should be considered where your investment involves a heavily regulated industry or agreements directly with a foreign state (or state-owned entity).

"Investment" for these purposes potentially covers a broad range of interests and transactions from mergers and acquisitions, joint ventures, purchases of securities or assets, project financing, concession contracts, green-field asset development, manufacturing plant construction and, in some cases, can also extend to cover financing transactions supporting investments, including transactions involving the provision of loans and promissory notes. As there is no common definition of "investment" used in investment treaties, each BIT or MIT will need to be considered to determine whether a particular investment or transaction falls within the scope of its protections. Deal makers should note, however, that there is a helpful trend for tribunals to rule in favor of a more expansive definition of "investment".

To be sure, you need not have a contractual relationship with a state party to be protected by a BIT or MIT. Rather, these treaties protect your investments in foreign states against a variety of wrongs that the foreign state might commit vis-a-vis your investment.

While the protections offered by BITs or MITs should be considered prior to effecting an investment transaction with a foreign state, if you have already entered into a relevant transaction, it may not be too late to restructure your investment in order to take advantage of the protections described below.

What are BITs and MITs and Why Can They Be Important to You as a Deal Maker?

Investment treaties such as BITs and MITs are legal instruments entered into by two or more states for the purpose of increasing their investment flow between the state parties. They accomplish this objective by offering foreign investors in the "home state" certain legal protections against adverse actions of the "host state" into which they are investing. The protections offered by such treaties can supplement any contractual arrangements an investor might otherwise have entered into with the state. Importantly, it also protects against the wrongful actions of the host state when no such contractual arrangements are in place.

If a host state has entered into an investment treaty with a home state that applies to a relevant investment, it is bound to give effect to its terms in favor of an investor in or from that home state. Historically, the record of successful claims against states under these treaties has been encouraging. Hence, if you structure your investment such that you will be treated as an investor from a relevant home state, you may be able to benefit from the types of protections discussed further below.

What Kind of Protections are Available?

Substantive Protections

Investment treaties commonly contain the following protections:

- *Expropriation:* Prompt, adequate and effective compensation in the event of substantial interference with property/investment;

- *Fair and Equitable Treatment (FET):* Protection from actions of the host state that undermine a foreign investor's legitimate, investment-backed expectations;

- *Full Protection and Security:* Assurance that the host state exercises sufficient diligence to maintain the physical security and, in some cases, legal security of the investment;

- *Nondiscrimination/Most-Favored-Nation Treatment:* Assurance that protected investors receive treatment no less favorable than that accorded to national investors, or investors from third states;

- *Free Transfer of Capital:* Rights granted to foreign investors to freely transfer funds related to the investment into and out of the host state; and

- *Umbrella Protection:* Obligations on the host state to observe specific undertakings toward foreign investors.

The breadth of protections under BITs and MITs are potentially wide and accordingly should be examined on a case-by-case basis before discounting the availability of an investment treaty remedy. For example, expropriation rights can apply where a state undertakes intrusive or "creeping" acts that cumulatively, though not individually, strip the investment of its economic value or removes control from the foreign investor. FET protections can under some treaties extend to subsequent actions of the state, for example changes in laws or regulations, withdrawals of essential licenses, imposition of new

duties or export quota or similar.

Procedural Protections

In addition to the substantive protections, BITs and MITs include procedural rights. One of the key attractions for investors is that violation of any of substantive rights is directly enforceable against the host state through international arbitration. Generally, investment treaties will permit investors to pursue arbitration before the International Center for the Settlement of Investment Disputes, otherwise known as ICSID, which is a part of the World Bank system, or under the Arbitration Rules of theUnited Nations Commission on International Trade Law, otherwise known as the UNCITRAL Rules. Resulting arbitral awards are final and binding on the parties to the dispute, and enforceable in most jurisdictions around the world, subject only to very limited grounds of annulment.

How Can You Take Advantage of Benefits of BITs and MITs in Practice?

The first thing to consider is what investment treaties the host state is a party to and who are the relevant home states. Once the relevant BITs/MITs are identified, an analysis should be undertaken to determine the scope of protections offered to different host states under the relevant BITs/MITs. This process will assist in identifying how to structure your investment in particular, whether it is feasible or practicable to set up an investment vehicle that will be treated as an "investor" of the relevant host state (notwithstanding that the ultimate "investor" or beneficiary is incorporated or based in another jurisdiction). This exercise will need to be undertaken in conjunction with other structuring and business considerations, including tax, governance, flexibility of corporate structures available in the different home states and ongoing compliance requirements.

In certain circumstances and depending on the scope of the relevant treaties, it may also be possible to structure your investment in order to avail yourself of protections under a selection of different BITs or MITs. This could be done by using a series of intermediate/holding investment vehicles, incorporated in different homes states, as some treaties afford protection not only to the (direct) foreign investor but also to shareholders in the relevant investor/investment vehicle.

When seeking to take advantage of investment treaty protections, each treaty will need to be reviewed for carveouts and exclusions. For example, a number of BITs carve out tax measures from the scope of their substantive protections. Others deny benefits to investors under certain circumstances, including where the investor employs "brass plate" companies in a home state to effect their investment, and yet others include carveouts for measures to protect the host state's culture and may include prescribed limitation periods.

In the context of investments with European Union member states, investors should note the possible impact of the Lisbon Treaty, which grants exclusive competence to the EU over foreign direct investment. This may mean that BITs negotiated directly between any EU member state and a non-EU state may not apply if and to the extent the EU has in place a negotiated investment treaty with that state.

How Effective is Investment Treaty Protection in Practice?

The question that deal makers raise when considering the substantive efficiency of investment treaty protection is how successful in practice the regime of protections under investment treaties have proved to be. There are today over 3,000 international investment agreements, 2,000 of which are BITs

protecting investments by "nationals" of the home state in the territory of the host states. Similar protections also exist under multilateral investment treaties, which provide rights for foreign investment within a network of participating host states. Some multilateral treaties cover a wide range of topics but typically include a chapter on investments. Examples include NAFTA (North American Free Trade Agreement), the Energy Charter Treaty and the forthcoming hotly debated Trans-Atlantic Trade and Investment Partnership (TTIP).

In the past, BITs have been seen as a creature of the West to protect investments in emerging markets, but this is no longer the case. There are a number of cases where intracontinental fights are staged and where western nations have been sued by investors from emerging markets.

Recent analysis of cases indicate that investors have won approximately 30 percent of reported cases against states in the context of investment treaty arbitrations, with another circa 30 percent resulting in settlement. Where the relevant treaty provides for arbitration before the ICSID and the host state is reliant on World Bank aid, there is an added incentive for the host state to comply with an ICSID arbitral award.

As noted above, protection under BITs or MITs can offer additional protection alongside contractual protections. They also have the potential to extend to a broader range of actions of the state or other governmental agency of the host state, which may be excluded under the terms of any contract, for example, due to negotiated limitations in force majeure clauses. Accordingly, investment treaty protections can serve to bridge a gap where other forms of deal security, such as insurance policy cover, do not respond.

As a matter of course, in the context of any investment transaction with a foreign government or state entity, whether with a developed or developing host state, BIT and MIT protections should be carefully considered.

Other Key Global Developments to Note — TTIP

The Trans-Atlantic Trade and Investment Partnership is a comprehensive trade and investment agreement currently being negotiated between the EU and the U.S.

An area of controversy related to TTIP is the inclusion of investor state dispute settlement (ISDS) provisions. Given the high profile of the TTIP negotiations, the ISDS provisions, which are typical in the several thousand investment treaties already in existence, have come under closer scrutiny. In particular, some are concerned with the ability of foreign investors to pursue claims directly against states before private international arbitral tribunals as opposed to state-sponsored judicial organs. Others are concerned with the chilling effect that claims by foreign investors could have on a state's ability to regulate in the interest of their public. Ultimately, it is likely that TTIP will provide foreign investors with some form of dispute resolution mechanism, but the form of that mechanism is still uncertain.

Current expectations are that agreement on the text of TTIP will not be reached before the end of 2015, but it is not inconceivable that TTIP will be in place by 2016 and hence this is a space to watch.

Key Takeaways

To recap, when proposing an investment in a foreign state, factor into your structuring considerations the availability of protections under relevant BITs and MITs. If you have already made your investment, it may be possible to restructure your investment through a holding company/entity in a home state in order to take advantage of investment treaty protections (without triggering termination, change of control, or other similar clauses under your existing investment contracts).

These are the key steps to consider:

- Identify the relevant BITs or MITs — are they in force?
- Ensure that your investment qualifies for protection;
- Compare the dispute resolution mechanisms under relevant BITs/MITs;
- Compare the principal substantive protections available; and
- Identify any potential exclusions or other pitfalls.

—By Cyrus Benson, Penny Madden and Nicholas Tomlinson, Gibson Dunn & Crutcher LLP

Cyrus Benson and Penny Madden are partners in Gibson Dunn's London office and co-chair the firm's international arbitration practice. Nicholas Tomlinson is a partner in London.

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