GIBSON DUNN

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UK NATIONALISATION – INVESTMENT TREATIES CAN OFFER OPPORTUNITIES TO REORGANISE NOW TO PROTECT VALUATIONS

To Our Clients and Friends:

The political instabilities caused by Brexit raise the possibility that a General Election may be held in the UK sooner than the scheduled 5 May 2022. Given current political turbulence, the prospect of Labour winning any such snap election can no longer be dismissed. If this happens, a future Labour government led by Jeremy Corbyn and John McDonnell is expected to consider nationalising a range of assets, including utilities (such as water, rail and energy), the Royal Mail and possibly even certain private finance initiative (PFI) companies. Nationalising profitable UK companies on this scale has not happened since the post-WWII 1945 Labour government.

How might nationalisation happen?

There is not yet much detail on how any nationalisation programme would be carried out. Industry-specific regulations and arrangements mean that the process will probably differ depending on the sector. Some businesses – e.g. rail, certain PFI contracts – are run under time-limited franchises and a Labour government might simply allow these contracts to run their course before bringing them back under government control. However, other utilities are run under perpetual licences (e.g. regional water franchises in England and Wales were sold, not leased). Here, the Government would need to impose a compulsory takeover, possibly issuing Government bonds to shareholders in exchange for their shares in the company owning the asset.

Valuations

It will not be possible to prevent the expropriation of these assets if it is approved by the UK Parliament. However, a key question will be how the owners of such nationalised assets will be compensated. Valuing shares is typically complex (especially with unlisted SPV ownership structures). Labour has suggested valuations would be made on a case by case basis, with a role for Parliament in the process. There is a concern, however, that Labour may seek to save money by refusing to pay full market value for the expropriated assets, or that the use of Government bonds as consideration may mean that payment is deferred over extremely long periods (some of the stock issued as consideration for the post-WWII nationalisations was not redeemable for 40 years).

Valuations that are seen as unfair will inevitably trigger compensation claims by investors. There are a number of routes to possible claims, such as under the Human Rights Act 1998 and/or the European Convention on Human Rights. However, investment treaties may offer some investors a better chance of reclaiming the full value of their expropriated investments. The standard of compensation under most investment treaties is fair market value. In order to take advantage of an investment treaty, an investor will need to have in place a corporate structure which includes an entity located in a jurisdiction that is party to an investment treaty with the UK to pursue a treaty claim.

What is an investment treaty?

An investment treaty is an agreement between states that helps facilitate private foreign direct investment by nationals and companies of one state into the other. Most investment treaties are bilateral (known as "**bilateral investment treaties**" or "**BITs**"), but the UK is also a party to the Energy Charter Treaty, which is a multilateral investment treaty with 51 signatories. The purpose of an investment treaty is to stimulate foreign investment by reducing political risk. Amongst other things, it is intended to protect an international investor if an asset it owns in the other state is subsequently nationalised without adequate compensation. Investment treaties generally provide that the overseas investor will receive fair and equitable treatment and that the compensation for any nationalisation will be appropriate and adequate. There are currently more than 3,200 BITs in force worldwide.

The definition of what constitutes an investment is usually quite broad including, for example, security interests, rights under a contract and rights derived from shares of a company.

Importantly, most investment treaties provide investors with a right to commence arbitration proceedings and seek compensation if the state has breached its obligations under the treaty (e.g. for failing to provide adequate compensation for a nationalisation). This means a UK investment treaty could offer an avenue of protection for an overseas investor of a nationalised UK asset. A list of countries with a UK BIT is here.

How to benefit from a UK investment treaty?

Some investors in UK assets that may be the subject of nationalisations are considering restructuring their UK investments to take advantage of investment treaties to which the UK is a party. In some circumstances, this can be achieved by simply including a holding company in the corporate chain which is located in a jurisdiction that has an investment treaty with the UK. So long as the restructuring is completed before a dispute regarding nationalisation arises, it will be effective. Therefore, investors who hold UK assets that potentially may be the subject of nationalisation should consider restructuring now.

The UK has investment treaties in force with over 100 jurisdictions but not all of them will be suitable for a restructuring. Investors will want to analyse not only the substance of the UK investment treaty to which the host country is a signatory (some are more rudimentary than others) but also other risk factors. In particular, investors will want to check the tax treatment of a particular investment vehicle, including making sure that the new company is not obliged under local rules to withhold tax on any interest or dividends. Equally, some jurisdictions may be considered unattractive because of geopolitical uncertainties or because their courts and professionals have limited business experience. The costs and governance associated with any possible restructuring would also need to be carefully considered, especially if the restructuring involves a jurisdiction where the new entity will be required to establish a more substantive business presence. Given all these risks, there are probably only a very small set of jurisdictions where investors might consider incorporating an entity within their deal structures.

Each investment treaty is different and the possible structure will depend on the exact terms of the relevant treaty. However, in general terms, the restructuring would usually involve the insertion of a new entity incorporated at the top of the corporate structure that holds the UK assets (but below any fund) via a share-for-share exchange with the existing holding entity.

Conclusion

If a future Labour government seeks to nationalise private assets it is inevitable that claims will be made, particularly regarding the amount of compensation paid to owners. Although it is not yet clear how a Labour government would assess compensation levels, investors may wish to consider structuring their investments so that they will have the option of using a UK investment treaty for any valuation disputes.

This client alert was prepared by London partners Charlie Geffen, Nicholas Aleksander and Jeffrey Sullivan, of counsel Anne MacPherson and associate Tamas Lorinczy.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please feel free to contact the Gibson Dunn lawyer with whom you usually work or any of the following lawyers:

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