REPRINT

corporate disputes

PROTECTING YOUR FOREIGN INVESTMENT

REPRINTED FROM:

CORPORATE DISPUTES MAGAZINE

OCT-DEC 2021 ISSUE

www.corporatedisputesmagazine.com

Visit the website to request
a free copy of the full e-magazine

GIBSON DUNN

Published by Financier Worldwide Ltd
corporatedisputes@financierworldwide.com
© 2021 Financier Worldwide Ltd. All rights reserved.

www.corporatedisputesmagazine.com

PERSPECTIVES

PROTECTING YOUR FOREIGN INVESTMENT

BY **LINDSEY SCHMIDT, BESMA GRIFAT-SPACKMAN AND ROSE NAING**
> GIBSON, DUNN & CRUTCHER LLP

Foreign investment can pay off substantially if successful, however it is often exposed to serious political risk. One of the primary ways to limit that risk is to structure (or restructure) the investment to ensure it is covered by the protections offered by bilateral or multilateral investments treaties.

We set out below a brief guide to the investment treaty framework and consider practical steps that can be taken by investors to ensure they maintain protection of their foreign investments, even where there is a transfer of assets.

What is an investment treaty and how can a foreign investment be protected?

Investment treaties are agreements between two or more foreign states which establish reciprocal undertakings between the signatories to protect and promote investments made by investors from one signatory state into another. They are favourable to host states because they encourage foreign investment and bring capital into the country. They are also favourable to investors by offering legal protection against adverse actions of the host state, including, for example, guarantees of fair and

equitable treatment, full protection and security and fair compensation in cases of expropriation.

The violation of rights offered under an investment treaty is directly enforceable against the host state through international arbitration, including before the International Centre for the Settlement of Investment Disputes (ICSID), or under the arbitration rules of the United Nations Commission on International Trade Law. There are currently nearly 3000 agreements in force, including both bilateral investment treaties (BITs) and multilateral investment treaties (MITs).

Not all foreign investments are protected because not all countries have signed BITs or MITs. Moreover, not all investment treaties offer the same protections. Some treaties will be narrower in scope, while other treaties will contain very broad substantive protections. It is therefore critical for investors to assess the structure of their investment to ensure the broadest possible legal protections in the event of a dispute.

Planning foreign investments

Investment treaty planning, like tax planning, is best advised at the start of any project, even before the investment is made. However, the structuring of a foreign investment can take place at any time prior to a dispute arising. Once a dispute arises (or is, foreseeable), it may be too late to seek the protection of an investment treaty as many tribunals will consider that impermissible 'forum shopping' and an abuse of the arbitral process.

For example, in *Philip Morris v. Australia*, the tribunal concluded that there had been an abuse of rights because, at the time of restructuring, the claimant was aware that legislation adverse to its interests would be enacted, and it was therefore "reasonably foreseeable" that a dispute would occur. Conversely, in *ConocoPhillips Petrozuata B.V. et al v. Venezuela*, the tribunal determined that the claimants had legitimately restructured their investment through Dutch subsidiaries – even though the sole business purpose of the restructuring was to obtain the protection of the Netherlands-Venezuela BIT – because ConocoPhillips restructured its investment prior to any threat of expropriation.

Thus, when considering the structure of a foreign investment, investors should first and foremost ensure that their foreign investment is protected under a BIT or MIT. Thereafter, investors should consider the specific protections contained in the relevant BITs or MITs and structure the investment so that it is covered by the most favourable investment treaty. In particular, investors should carefully consider the language of the following protections.

The nationality requirement. An investor will need to consider the proper person or entity to make the foreign investment so as to qualify as an 'investor' under the BIT or MIT.

The investment requirement. In investment treaty arbitrations, arbitral tribunals carefully assess the nature of the 'investment' made by the person or entity to ensure it qualifies for protection under the BIT or MIT. For example, in ICSID arbitrations, tribunals frequently employ the 'Salini' test, which considers: (i) whether the investor has made an economic contribution to the host state; (ii) the duration of the investment; (iii) whether the investor has taken on some risk for the investment; and (iv) whether the investor has made a contribution to the economic development of the host state. Moreover, some treaties protect direct investments only, while others include indirect ones such as shareholdings.

Consent of the state to arbitration is essential, and foreign investors have to ensure that, one way or another, the host state has or will consent to arbitration should a dispute arise. Consent from the

state to an arbitration clause may take many forms, such as a clause in an investment agreement, share purchase agreement or an approval of a transfer of assets, to a consent to arbitration.

Given the varying scope of investment treaties, investors should be sure that in structuring or restructuring their foreign investment, they are taking advantage of the most favourable investment treaty available. Otherwise, they may not be getting all of the protections they bargained for.

"One key consideration is the timing of any transfer, disposal or assignment of property in relation to the institution of the arbitral proceeding."

Ensuring that treaty protection follows the foreign investment

One issue that frequently arises is whether investments continue to be protected when they are transferred through a sale to a third party or as part of an intra-group restructuring. A transfer of assets is generally assumed to transfer a right to a claim should a dispute arise in relation to the newly acquired assets. However, when successors fail to plan their foreign investment, issues may arise in terms of the investor's standing in an investor-state arbitration.

One key consideration is the timing of any transfer, disposal or assignment of property in relation to the institution of the arbitral proceeding. For example, in *Ceskoslovensak Obchodni Banka A.S. v. Slovakia*, the claimant's assignment to the Czech Republic of all claims against a Slovak agency at a future date (but not before the completion of the arbitration) did not deprive the claimant of the requisite standing under Article 25(1) of the ICSID Convention because the assignment took place after the arbitration proceeding had already been instituted.

Thus, the Czech Republic as the assignee (and for all practical purposes, the beneficial owner of the disputed claims) was not found to be the real party in interest in the proceedings. The decision was in line with the general rule that an investor must own the investment at the date the arbitration proceedings are instituted.

Other factors may also affect jurisdiction, such as the specific nature of corporate restructuring. For example, in *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, after the tribunal had already determined at the

jurisdictional phase that claimants had standing to bring the claim, claimants underwent corporate restructuring. This prompted a challenge from the respondent on the grounds that the new entity had not established itself as the successor-in-interest to the original claimants. However, the tribunal found that the new entity, despite the intervening name change and corporate mergers, continued to hold the majority stake in the original entity, such that the parties remained the same as in the original submission.

In addition, if corporate restructuring leads to a change in nationality, that could defeat jurisdiction. For example, in *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, the Canadian claimant filed for bankruptcy in the US after the arbitration was already commenced. It transferred its major operations to a new US company, but it assigned its North American Free Trade Agreement (NAFTA) claim to a newly created Canadian company, Nafcanco, which was owned by Loewen's US subsidiary. The tribunal disqualified Nafcanco, finding that the new US company was the real beneficiary of any award and the real party in interest and noting that "such a naked entity as Nafcanco… cannot qualify as a continuing [Canadian] national for the purposes of this proceeding".

Thus, a transfer of assets or intra-group restructuring may leave foreign investments exposed. It may therefore be helpful for foreign investors to consider the following advice when acquiring assets with a foreign aspect to it, or when reorganising assets within a group of companies.

First, carefully review the protections that may be offered to the investment to ensure that a foreign investment is fully protected. For instance, if the nationality of the buyer of the assets is different from the nationality of the seller, protection may be lost.

Second, consider at the time of acquiring foreign assets whether there is an ongoing dispute or not, and whether the transfer would have any effect on a right to file a claim against the host state. If a dispute has arisen with a state before a transfer of assets but a claim has yet to be filed, ensure that the transfer of assets includes transfer of the treaty right.

Third, carefully draft and review the (initial) agreements with a foreign state when investing abroad to ensure that the state consents to arbitration.

Fourth, attempt to get state approval for a transfer of assets to ensure their protection.

Finally, consider whether jurisdictional objections based on forum shopping or abuse of process may be successful.

Conclusion

Foreign investors should always consider the extent to which their foreign investments may be protected before any investment in a foreign

country is made, and in particular keep in mind the various pitfalls that can remove protection when assets are transferred. Otherwise, they incur the risk of losing the entirety of their foreign investment should a dispute with a state occur without obtaining adequate compensation. CD

Lindsey Schmidt
Partner
Gibson, Dunn & Crutcher LLP
T: +1 (212) 351 5395
E: lschmidt@gibsondunn.com

Besma Grifat-Spackman
Associate
Gibson, Dunn & Crutcher UK LLP
T: +44 (0)20 7071 4207
E: bgrifat@gibsondunn.com

Rose Naing
Associate
Gibson, Dunn & Crutcher UK LLP
T: +44 (0)20 7071 4014
E: rnaing@gibsondunn.com