

INVESTMENT TREATY PROTECTION: A WHISTLESTOP TOUR

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Legal Briefings - By **Christian Leathley, Andrew Cannon, Iain Maxwell** and **Naomi Lisney**

In 2016, it is difficult for mining companies to ignore the importance of the protections that bilateral and multilateral investment treaties ("**BITs**") can offer.

In this article, we provide a brief background to BITs, why they offer such valuable protection, and how best to structure investments to take advantage of them.

Since the beginning of the year, investors have started ICSID arbitration proceedings regarding mining concessions against Colombia, Kazakhstan, Panama and Ghana. 2016 has also seen Canadian gold-mining company Crystallex International Corporation secure one of the largest awards in ICSID history in the amount of US\$1.202 billion (plus pre- and post-award interest), for unfair and inequitable treatment and the unlawful expropriation of its investment in the Las Cristina mining project in Venezuela, as well as Mongolia's payment of \$70 million to uranium miner Khan Resources after the latter was awarded \$100 million in damages by an ICC tribunal last year as compensation for Mongolia's cancellation of its mining licences for the Dornod uranium project in 2009.

Of course, the economic viability of an investment may suffer significant damage in less overt ways. In a [report](#) published in November 2013 on "Conflict and Coexistence in the Extractive Industries", Chatham House identified "resource nationalism", tensions with local communities, and environmental issues as the key drivers of company-government disputes in the extractive industries - "resource nationalism" referring to moves by producer countries to gain greater control of their country's resources. In many cases, where the government seeks to renegotiate what it perceives as an unfair deal, the parties will be able to come to a new agreement, cooperating to ensure that the host country's legitimate policy concerns are addressed. Where a government reneges on an agreement or changes its terms in an arbitrary and unfair manner, however, the investor may need take a hard line and seek redress through arbitration.

In order to ensure that the maximum possible BIT protection will be available in such circumstances, it is important to understand and consider the protections that BITs can offer and consider how best to structure a project or investment in advance to take advantage of the best available BITs.

BITS - WHAT ARE THEY AND WHY DO YOU NEED TO KNOW ABOUT THEM?

BITs are treaties between two states that provide various protections to investors from one state (the investor's home state) in the other state (the host state of the investment), usually including the right to bring arbitration proceedings directly against the host state and obtain compensation in circumstances where the protections in the BIT have been breached by the host state.

The protections afforded by individual BITs vary according to the language of the BIT. However, some or all of the following key investor protections are found in the majority of BITs:

- The host state will not expropriate the investment without the payment of prompt, adequate and effective compensation;
- The host state will ensure fair and equitable treatment of the investor and its investment;
- Treatment shall be afforded that is no less favourable than that afforded to nationals of the host state (national treatment) or investors of any other state (most favoured nation treatment);
- Full protection and security of the relevant investment within the territory of the host state;
- An umbrella clause, enabling claims arising from a contract between the investor and the host state (or a state-controlled entity) to be heard as a claim under the BIT; and
- A right for the investor to bring arbitration proceedings against the host state for breach of any of the protections afforded by the BIT.

Whilst investors may also be able to acquire protection and the right to bring arbitration proceedings against a state through an investment agreement or via a domestic law on foreign investment, BITs provide a number of advantages. In particular:

- There is no need for a direct contractual relationship between the host state and the investor;
- A qualifying investor can take advantage of the protections under the BIT even if it would not have the leverage to negotiate such protections itself in its own contract with the host state. Even if it has such leverage, the existence of BIT protection may be sufficient to allow an investor to expend its negotiating capital in other areas;
- The right to bring arbitration proceedings directly against the host state is particularly valuable, preventing the investor being forced to seek redress in the host state's own courts. BITs are the basis for state consent to arbitration in the majority of cases that are administered by the International Centre for the Settlement of Investment Disputes ("**ICSID**"), the best known neutral forum for settling investment disputes; and
- BITs can also be used to reduce the cost of political risk insurance.

In order to be protected and able to bring a claim under a BIT, there will be a number of jurisdictional hurdles for a would-be claimant to overcome. These vary across BITs but usually the claimant must be a qualifying investor (a national or company of one party to the BIT) holding a qualifying investment located in the other state party to the BIT. Also relatively commonplace are requirements to have exhausted the remedies available in the national courts or to attempt amicable settlement of the dispute for a specified amount of time (known as a "cooling off period") before commencing arbitration proceedings.

STRUCTURING INVESTMENTS AND MAXIMISING TREATY PROTECTION

There are now approximately 3,000 BITs in force and a number of other regional or sector based multilateral treaties that provide similar protections. As such, it may be that there is already a treaty in place between the investor's home state and the host state of the investment providing the key protections discussed above. If so, and if there are no significant downsides to that treaty, the investor may already be well protected and no further steps would be required to obtain BIT protection.

However, if there is no such treaty in force, or if there is such a treaty but it provides inferior protection, the investor should consider whether by careful structuring of its investment it can obtain access to the more favourable protection offered by a treaty between the host state and another third state. This is usually done by investing through a corporate entity of that third state.

When it comes to structuring or restructuring investments to obtain the maximum BIT protection, the major issues that investors should take into account include:

- Whether there is a helpful BIT between the investor's home state and the host state;
- If not, whether there is a more helpful BIT between the host state and a third state, such that the investment may be structured or restructured so that the investor has the required nationality under that BIT;
- How best to ensure that the investment is a qualifying investment for the purposes of the BIT on which the investor intends to rely; and
- How and when an investment can be restructured to take advantage of that BIT.

ISSUES OF NATIONALITY

To be entitled to the protections afforded by a particular BIT, an investor must ordinarily qualify as a national of the state party to the BIT which is not the host state of the investment.

A company will ordinarily qualify as a national of its place of incorporation or registration. If an investor is not itself a national of the state party to the BIT on which it wishes to rely, it may be able to obtain such protection by investing through an entity which does have such nationality, with that entity then protected by and able to bring an arbitration under the BIT in question. This is the most common strategy for investors engaged in investment treaty structuring, and one that will, with careful planning, usually be effective.

However, it is important to consider the wording of the BIT in question. Some more recent BITs contain a "Denial of Benefits" clause denying the benefit of the BIT to shell companies or companies without a substantial business presence at their place of incorporation, a step taken specifically to prevent treaty shopping. In addition, while in many instances arbitral tribunals have held shell companies to be qualifying investors under BITs without such a "Denial of Benefits" clause, other tribunals have held that passive ownership of shares in a company that in turn owns the investment is not sufficient. It will therefore be important when engaging in investment treaty structuring to consider relevant arbitral awards, particularly any under the BIT on which an investor may wish to rely.

ENSURING THE INVESTMENT QUALIFIES FOR PROTECTION UNDER THE BIT

Once a helpful BIT is identified it is also crucial to consider whether the proposed foreign investment will fall – or can be structured so as to fall – within the scope of the definition of qualifying investments in that BIT. The definition of investment varies across BITs but commonly comprises a non-exhaustive list of types of asset. It is preferable to structure an investment to take advantage of a BIT where the investment falls within one of the specific categories of assets listed.

In addition, if a claim will be heard in an arbitration pursuant to the ICSID Convention, it will be necessary to satisfy the separate "investment" requirement of the ICSID Convention. There is some investment arbitration 'case law' offering guidance on what constitutes an investment for the purposes of the ICSID Convention. It posits four elements that are indicative of an investment, namely:

- a contribution or commitment made by the investor;
- in an investment of a certain duration;
- the existence of a risk for the investor; and
- a significant contribution to the economic development of the host state.

Investment arbitration 'case law' is divided on whether the presence of all four elements is essential for a purported investment to fall within the ICSID definition of "investment" or whether the presence of some elements is sufficient. It is generally accepted that short term investments, such as one-off sales contracts or mere supply contracts, are unlikely to qualify as investments.

TIMING

Strategic structuring of investments to maximise BIT protection does not always occur at the time the investments are made, and there may be good reasons for wanting to secure or upgrade BIT protection after the initial investment has taken place. Whether or not it is possible to benefit from enhanced BIT protection as a result of such restructuring largely depends on when the restructuring occurs. Arbitral tribunals constituted to resolve BIT-related disputes have shown in the past that they are concerned to identify circumstances constituting an abuse of process and may deny treaty protection where it is clear that the claimant has restructured its investment after a dispute has arisen solely in order to secure enhanced protection.

Four factors have emerged from the case law as relevant to the question of whether restructuring has been undertaken in good faith:

- the timing of the investment;
- the timing of the claim;
- whether the restructuring transaction had substance; and
- whether the investor (the new entity in the corporate structure) genuinely intended to perform any economic activities.

It is often difficult to determine at what stage in a developing situation the actual dispute arises. For practical reasons, it is therefore advisable to seek advice on – and consider carrying out – any restructuring as soon as any possible need to rely on BIT protection is perceived. Undoubtedly however the safest course is to plan appropriately at the time the investment is made.

IMPACT OF WITHDRAWALS, TERMINATIONS AND POLICY CHANGES ON BIT PROTECTION

It is perhaps unsurprising in view of the increasing number of successful BIT claims by investors in recent years that there has been a backlash, with certain states seeking to reduce their exposure to claims from foreign investors (some of whom they may not even be aware have an investment in their country). The three principal ways in which states have attempted to do this are:

- through denunciations of the ICSID Convention;
- by withdrawing from BITs; and
- by revising policies in relation to future BITs.

ICSID DENUNCIATIONS

Since 2007, Bolivia, Ecuador and Venezuela have all denounced the ICSID Convention. There are different schools of thought regarding the effect denouncing the ICSID Convention has on the right of investors to commence BIT claims under the ICSID Convention.

If ICSID arbitration ceases to be available as a result of a host state's denunciation of the ICSID Convention, investors may be able to rely on an alternative form of dispute resolution specified in the arbitration provision of an applicable BIT, provided one is available. However, if the only option provided for in the BIT is ICSID arbitration then an investor may no longer be able to enforce its rights under the BIT. When structuring an investment, and where there is a choice of BITs, falling within the scope of a BIT with several dispute resolution options is therefore preferable.

BIT TERMINATIONS

Some BITs have been terminated in the last few years, including by Bolivia, Ecuador, Venezuela, South Africa and Indonesia.

Termination of a BIT once an investment is made is unlikely to have an immediate impact, as most BITs have both a notice period (typically six months) and a sunset provision (typically ten or more years) during which existing investments will remain protected. For example, Italian investors into Indonesia as at 23 June 2015 (the date of termination of the Indonesia-Italy BIT) will be protected until 23 June 2025; Indonesia's BITs with Hungary and Singapore, which terminated on 2 February 2015 and 20 June 2016 respectively, also contain a ten-year sunset clause. It is however of course important for an investor to check, before making its investment, that the host state has not served notice or otherwise indicated its intention to terminate a BIT on which the investor plans to rely.

THE FUTURE OF INVESTOR-STATE DISPUTE SETTLEMENT: THE EU'S PROPOSED INVESTMENT COURT, AND BREXIT

In response to concerns within the EU regarding the use of arbitration to settle disputes under BITs, the EU Commission is now pursuing an alternative model for its future investment treaties, where disputes will be resolved before a standing international investment court, rather than in an ad hoc international arbitration by arbitrators appointed by the parties to the dispute. While no treaties including such a model have entered into force, and there are uncertainties about how such a court would operate in practice, the model has been agreed in principle for the agreements at an advanced stage between the EU and Vietnam, and between the EU and Canada (the Comprehensive Economic and Trade Agreement, or CETA). These agreements are intended to replace existing BITs between EU Member States and those counterparties, and to do so without application of the relevant sunset provisions. The EU is also pushing for the inclusion of this model in the Transatlantic Trade and Investment Partnership (TTIP) it is negotiating with the United States, and is likely to push for its inclusion in all future investment treaties it enters into.

UK investors will, of course, also need to keep under consideration the potential impact of Brexit on investments currently protected by existing EU and UK agreements.

SUMMARY

These recent developments highlight the importance of considering BIT protection not only at the time an investment is made, but also during the lifetime of the investment, monitoring relevant developments in the available BIT protections, as the landscape and available treaties may change over time.

However, despite the recent backlash and these future uncertainties, BITs remain a valuable tool by which investors in the mining (and other) industries can, with a little foresight and advance planning, obtain further valuable protections for their projects and investments.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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