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PROTECTING AGAINST WRONGFUL STATE ACTIONS: STRUCTURING INVESTMENTS TO ALLOW A REAL POSSIBILITY OF RECOURSE

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Legal Briefings – By **Brenda Horrigan and Hannah Ambrose**

Mining companies are no strangers to risky environments and threats of political upheaval. In an era of growing resource nationalism and increased environmental and populist activism, these risks are augmented – particularly in jurisdictions where governmental stability is uncertain.

Legislative, regulatory and attitudinal changes can happen rapidly irrespective of perceived goodwill and positive rapport with existing government officials. The implications for those caught off guard can be catastrophic, with possible significant detrimental effect on the earning potential of investments. Legislative changes can represent wholesale amendments to the regulatory backdrop to the investment, as can be seen in the recent changes to the natural wealth and resources legislation in Tanzania and the proposed new mining code in the Democratic Republic of the Congo, or incremental changes, such as the introduction of rules to re-balance the interests of indigenous peoples and investors in relation to natural resources. Where such actions are taken by states in a non-discriminatory fashion for a justifiable legislative purpose, and do not contravene the legitimate expectations of investors, they usually raise no issue. Where, however, such state actions are arbitrary, discriminatory or without legitimate purpose, they can create havoc for investors and in some instances violate international law.

While no investor can completely insulate their investment from these kinds of challenges, unquestioningly accepting the inevitability of 'sovereign risk' deprives investors – including international mining companies – of a comprehensive understanding of the pricing risk matrix. Careful consideration of rights derived from international law can give mining companies important tools to mitigate these risks. In addition, there are a number of measures which mining companies can take at the outset of an investment project to help protect that investment against arbitrary and/or discriminatory state acts.

By planning ahead, investors can enhance the security of their investments and their negotiating leverage with the host state in the event of an unanticipated disruption. Such leverage can help to protect and preserve the smooth operation of the investment project – and help to provide an avenue for recourse against the host state in the event arbitrary and/or discriminatory state acts do occur.

HOW DO POTENTIAL PROTECTIONS ARISE?

Typically, a foreign investor into a state has contractual rights against only its contractual counterparty in the event of a dispute. In mining contracts where the counterparty is a foreign state (e.g. under concession or license agreements), the investor may have contractual claims against the state itself – either in the state's domestic courts or, if the contract includes an arbitration agreement, before an international arbitration tribunal.

However, investors who plan ahead may also be able to benefit from additional protections against arbitrary and/or discriminatory treatment by a host state under a bi- or multi-lateral treaty. Many such treaties include a mechanism pursuant to which a foreign investor can take direct action – usually in international arbitration – against a host state if that host state, in violation of the treaty, takes/omits to take certain actions in a manner that damages the investment. The provisions granting right of the investor to take direct action against a host state under the treaty are often referred to as "ISDS" (or Investor State Dispute Settlement) provisions.

WHAT TYPES OF PROTECTIONS CAN BE AVAILABLE?

Whilst each treaty is different, there are a number of fundamental substantive protections or guarantees which are typically included. One of the most valuable protections is the guarantee of fair and equitable treatment (or "FET"). This is an absolute standard and is not relative to the protection provided to any other investor, either domestic or foreign. Its application is fact-specific. Claims under FET provisions typically fall into two broad categories: prohibitions against a denial of justice, usually attributable to the treatment of an investor by the courts of a host state; and claims based on administrative decision-making.

Not all regulatory changes will constitute a violation of the FET standard, and the existence of such protections does not deprive a state of its ability to exercise its regulatory powers. However, where the state's exercise of its regulatory power is based on procedural unfairness or lack of due process, bad faith, discrimination or a failure to protect an investor's legitimate expectations as to how they will be treated, a FET claim may be warranted. A recent example is the claim brought by Crystallex International Corporation against Venezuela for breach of the FET standard based on its failure to secure a required environmental permit after several years invested in a project to exploit gold reserves.

Another important guarantee included in many investment treaties is that investors will receive treatment that is no worse than that afforded to the host state's nationals. This right protects foreign investors from special requirements that would result in a competitive disadvantage in comparison with domestic investors. In a similar way, most favoured nation ("MFN") treatment under many treaties effectively guarantees investors no less favourable treatment than the treatment the host state accords to investors from any other country. Therefore an investor may be able to rely on broader or more effective protections found in another treaty signed by that host state.

A treaty may also contain a guarantee of full protection and security for the investment. Such a standard has been interpreted (although by no means consistently) as offering a guarantee that extends beyond physical protection of an investment to the security of the environment in which the investment is made. In Copper Mesa Mining's claim under the Canada-Ecuador BIT, for example, the tribunal found that Ecuador had breached a number of treaty provisions, including violating the guarantee of full protection and security, by virtue of its flawed reaction to the anti-mining blockade of one of Copper Mesa's concessions.

Treaties also regularly include protection against unlawful expropriation of an investment, whether directly or indirectly through a series of governmental acts which encroach on an investment and result in it being deprived of value. An example is the successful unlawful expropriation claim brought by Rusoro Mining against Venezuela with respect to the nationalisation of its investment constituting mining concessions and contracts to explore and produce gold. Similarly, Glencore is currently bringing a claim against Bolivia for, among other things, expropriation of two tin and antimony smelting plants and a tin and zinc mine.

Examples of indirect, or "creeping", expropriation are fact-specific, but might include legislative change to increase a state's share in mining outputs (either directly or by requiring that processing activity to take place in the host state); arbitrary or discriminatory failure to renew, or revocation of, licences or permits; certain changes in taxation regime or taxation assessments; and/or arbitrary or discriminatory termination of concessions or other interference with the exercise of contractual rights. A new government may be seeking political capital from undoing the actions of its predecessor (e.g. Bolivia's nationalisation of various mining interests under the administration of President Evo Morales), or the conduct may simply be a reaction to public feeling concerning a particular project (e.g. the revocation by Peru of a decree which authorised Bear Creek Mining Corp to acquire, own and operate certain mining concessions).

HOW CAN INVESTORS TAKE ADVANTAGE OF SUCH PROTECTIONS?

In order for an investor to benefit from these provisions, there needs to be a treaty in place between the investor's home jurisdiction and the host state which also contains ISDS provisions that provide for direct resolution of disputes between the investor and the host state, usually by means of international arbitration.

Australia, by way of example, has numerous treaties containing investment protections and ISDS provisions with countries across the world, including Indonesia, China, the Philippines, and various Latin American countries. The same types of protections can also be found in some economic partnership agreements, as well as bilateral and multilateral free trade agreements, such as the Thailand-Australia Free Trade Agreement (under which Kingsgate is bringing a claim against Thailand in respect of closure in 2016 of a goldmine, owned and operated by its subsidiary) and the recently signed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (**CPTPP**).

Where there is not a treaty in place between the investor's home jurisdiction and the host state that incorporates substantive protections and ISDS provisions, it is often possible, at the outset of a transaction (or at a minimum before a dispute arises), to structure the investment to be made via a subsidiary or other entity in a country which does benefit from such a treaty. Treaty protection should therefore be a significant consideration at the early stages of a project and can be factored into the pricing of investment risk. It is accordingly worthwhile to consider structuring for investment protection at the same time as reflecting on the most tax efficient investment structure.

WHAT IS THE PROCESS FOR EFFECTIVELY ENFORCING TREATY RIGHTS?

An important aspect of investment treaties is the mechanism by which the substantive protections granted to investors can be enforced. Many such treaties provide for the investor to elect to **arbitrate** disputes between it and the host state before an independent *ad hoc* international arbitration tribunal. Mining companies have taken advantage of this procedural right in order to avoid having to bring a claim against the host state before that host state's domestic courts, due to a concern that the courts may not be able to deliver timely resolution or may not be sufficiently independent of the state. Access to international arbitration also alleviates the need to entreat the investor's home state government to seek a resolution through diplomatic channels. In this way, it provides a more even playing field for investors possessing differing levels of political clout with their own governments.

Mining companies operating overseas of course need to know and understand the domestic legal framework relating to their investment. Many countries, particularly those that are seeking to attract FDI, have an investment code or investment law that may contain protections or guarantees governing the legal treatment of investments made in the territory. Similarly, the existence of possible avenues of redress under international law does not negate the need for contractual protections in relation to an investment. However, notwithstanding contractual risk management, foreign investments remain vulnerable to the vagaries of state power. Investment treaties can therefore provide a valuable risk-mitigation tool for those establishing mining operations abroad.

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