MINIMISING RISK THROUGH INVESTMENT PROTECTION AGREEMENTS

GOWLING WLG

INTRODUCTION

Companies or individuals investing in a foreign country can take pre-emptive steps to protect their investment from harmful interference by the State where the investment is made. International investment agreements offer wide substantive protection against State actions aimed at expropriating or diminishing the value of an investment. By structuring an investment (whether in the context of cross-border mergers and acquisitions, contracts with States or State-owned enterprises, stand-alone projects or otherwise) properly at an early stage, investors can ensure that they obtain the benefit of the protections on offer.

These protections are particularly important when investing in countries and industries involving a high risk of governmental or regulatory interference, or where high-profile and valuable assets are involved.

Gowling WLG can help investors to structure or re-structure their investments to maximise the protections from State interference that are available. If a dispute does then arise, our arbitration team has the necessary experience to seek redress for any damage caused or loss suffered.

INTERNATIONAL INVESTMENT AGREEMENTS

Investment protections can be found in a wide variety of treaties, agreements or legislation. Most commonly these are found in Bilateral or Multilateral Investment Treaties ("BITs" or "MITs"). A BIT is a treaty between two States under which each State grants protections and rights to "investors" from the other State. Those protections are, generally speaking, governed by standards of public international law, and step outside the confines of national law regimes.

A MIT offers many of the same protections as a BIT, but is made between multiple countries each offering protections to investors from the other contracting States. Notable examples include the Energy Charter Treaty ("ECT"), which offers protection for energy sector investments, and the North American Free Trade Agreement ("NAFTA"), which provides mutual investment protection between North American signatory States.

There are some 2,500 BITs and MITs in operation (with even more signed and awaiting ratification).

WHAT PROTECTIONS ARE ON OFFER?

The specific protections and their precise extent will vary depending on the treaty. Some of the most common rights/promises offered to investors and their investments under BITs and MITs include the following:

- not to expropriate or nationalise investments except for a public purpose and on a non-discriminatory basis, without payment of prompt, adequate and effective compensation;
- to accord fair and equitable treatment to investments made by investors in the "host State" (i.e. the State in which the investment is made);
- not to treat investors or their investments less favourably than the host State's domestic investors;
- to allow the repatriation of profits and property;
- not to take unreasonable or discriminatory measures against investors from the other signatory State; and
- not to breach contracts entered into between the host State (and its agents) and the investor;
- to accord full protection and security (including protection by the State from interference by third parties);
- the provision of a secure environment for the investment, and compensation for damage caused by civil disturbance, etc.

Critically, also, most BITs and MITs provide the right for an investor to bring a direct claim against the State for breach of these promises, usually by way of a claim before an international arbitral tribunal instead of the State's domestic courts. Accordingly, if the host State or its agents (such as regulators, tax authorities, security forces, local and/or licensing authorities) take steps that negatively impact on the value of the investments, an investor can seek compensation from a neutral tribunal, for example, acting under the auspices of the International Centre for the Settlement of Investment Disputes ("ICSID"), or of other international arbitral institutions or rules.

HOW TO BENEFIT FROM THESE PROTECTIONS?

The corporate structure that investors adopt for an investment is the key means by which they can benefit from the protections on offer. A prudent investor will structure (or re-structure) the ownership of its foreign investments to secure the maximum protection under existing treaties: specifically, by including within the ownership structure a company with the nationality of a State that is party to a BIT or MIT with the host State.

Since the precise terms and extent of the protections available will vary treaty by treaty, advice should be sought to choose the most appropriate nationality in the context of the given deal or investment.

Whilst it is generally permissible to structure investments in this way, if an ownership restructuring takes place after a dispute with a host State has arisen, the protections sought under a given treaty may not be available, highlighting the importance of structuring (or re-structuring) as early as possible. Ideally, this should take place at the very outset of the investment.

Similarly, treaties and the protections available may change over time, so it is important to review periodically foreign investment ownership structures to ensure that previously secured protections have not been lost and that any remedial action can be taken in good time.

QUALIFICATION REQUIREMENTS: "INVESTMENT" AND "INVESTOR"

Only qualifying "investments" made by a qualifying "investor" will obtain the investment protections on that may be on offer. The precise meaning and scope of those terms will be treaty-dependent, and care needs to be taken when selecting a particular structure to ensure that the "investor" and "investment" meet the criteria.

WHAT CONSTITUTES AN "INVESTMENT"?

There is no general definition of the term "investment" in international investment law and investment treaties commonly provide their own unique definitions of what is meant by an "investment". It is nevertheless possible to identify a number of common characteristics identified by arbitral tribunals in claims brought under investment treaties. Generally speaking, an "investment" will require:

- a contribution or commitment by the investor;
- performance of a project for a certain duration;
- the existence of a risk for the investor; and
- arguably, a contribution to the economic development of the host State.

Assets that will often constitute "investments" include:

- movable and immovable property (and associated property rights such as mortgages and liens);
- shares and other forms of participation in a company;
- claims to money or performance under a contract (including loans and debt or financial instruments);
- IP rights; and
- business concessions, licences or authorisations conferred by law or under a contract.

In relation to shares, where a company through which an investment is made is incorporated in the host State and does not itself qualify as a foreign investor, its foreign shareholders can bring a claim in their own right. That is the case whether they have direct shareholdings, or indirect shareholdings, including through intermediate companies incorporated in the investor's home State, the host State or a third State (i.e. a State that is not a signatory to an investment protection agreement relevant to the investment).

The size of a shareholding is not a relevant consideration. Generally, minority shareholders can bring claims seeking compensation for damage to the value of their minority shareholding.

WHO QUALIFIES AS AN "INVESTOR"?

In the most general terms, an "investor" is an individual person or business entity that makes a qualifying "investment" (as described above) in a relevant territory and is of a nationality that is entitled to protection under the relevant BIT or MIT. However, the precise meaning will depend on the definition contained in each treaty.

In the event of a dispute arising under a BIT/MIT, establishing that the "investor" has a nationality protected by the relevant treaty will be a critical issue. Under most BITs and MITs, nationality will determined according to the domestic law of the country where a natural person claims nationality or a business entity is incorporated.

However, for business entities, some BITs apply the concept of the seat of company management or control as the factor determining nationality. In addition, in some cases there are even more demanding requirements aimed at preventing "forum shopping" (i.e. the insertion of shell companies into corporate structures solely for the purpose of obtaining investment protection) through so-called "denial of benefits" clauses. Such provisions provide that in order to qualify for protection under a relevant treaty, a company "investor" must show that they conduct substantial business activities in their home State.

In short, advice on the precise terms of relevant BITs and MITs should be sought when putting in place investment protection structures to ensure that the qualifying conditions relating to "investments" and "investors" are satisfied in the context of the transaction.

TAX CONSIDERATIONS

An investment protection-geared restructuring is likely to have tax implications. Consequently, it is essential to adopt a multi-disciplinary approach to ensure that maximum investment protection coincides with maximum tax efficiency, for example, by choosing jurisdictions with the necessary tax exemptions for income repatriation. Double tax treaties can help investors in this respect, provided that an investor is able to meet the formal conditions that they commonly impose and ensure that they do not fall foul of any tax avoidance measures.

There are a number of jurisdictions that offer both a favourable tax and regulatory climate and have concluded a large number of BITs. Preferred holding company jurisdictions for investment protection and tax structuring purposes in different parts of the world include: Mauritius and the Netherlands for African investment; Hong Kong, the Netherlands and Singapore for investment in South East Asia and the Pacific; and Luxembourg, the Netherlands and Spain for Latin American investments.

OUR INVESTMENT "HEALTH CHECK"

Gowling WLG offers to conduct a "health check" on your existing (or planned) investments to determine whether they are (or will be) effectively protected from investment risk. If the protection is inadequate or not in place, we are able to identify what remedial steps should be taken to implement or strengthen it, and we will work with you to give effect to those proposals.

That service includes:

- identifying with you the investments that need protecting and considering the risks that they face;
- analysing what BITs/MITs are in place that you could benefit from;
- ensuring that definitions of "investor" and "investment" and any other relevant BIT/MIT conditions are met;
- advising on what available BITs/MITs have the most effective and relevant protections;
- considering what dispute resolution options are available and the circumstances in which they can be used; and
- considering with you the tax implications of possible investment protection-geared structures.

CONTACT DETAILS

GORDON BELL

Partner, London
International Arbitration

T +44 20 7759 6703
M +44 7799 343380
Gordon.Bell@gowlingwlg.com

MICHAEL DAROWSKI

Partner, London
International Arbitration

T +44 20 7759 6479
M +44 7921 498596
Michael Darowski@gowlingwlg.com

WENDY WAGNER

Partner, Ottawa
International Trade

T +1 613 786 0213
Wendy.Wagner@gowlingwlg.com

RICHARD DEARDEN

Partner, Ottawa
International Trade

T +1 613 786 0135
Richard.Dearden@gowlingwlg.com

GOWLING WLG (UK) LLP
T +44 (0)370 903 1000

gowlingwlg.com