Protecting Your Investments from Growing Resource Nationalism and Lawfare Offensive Through International Investment Treaties

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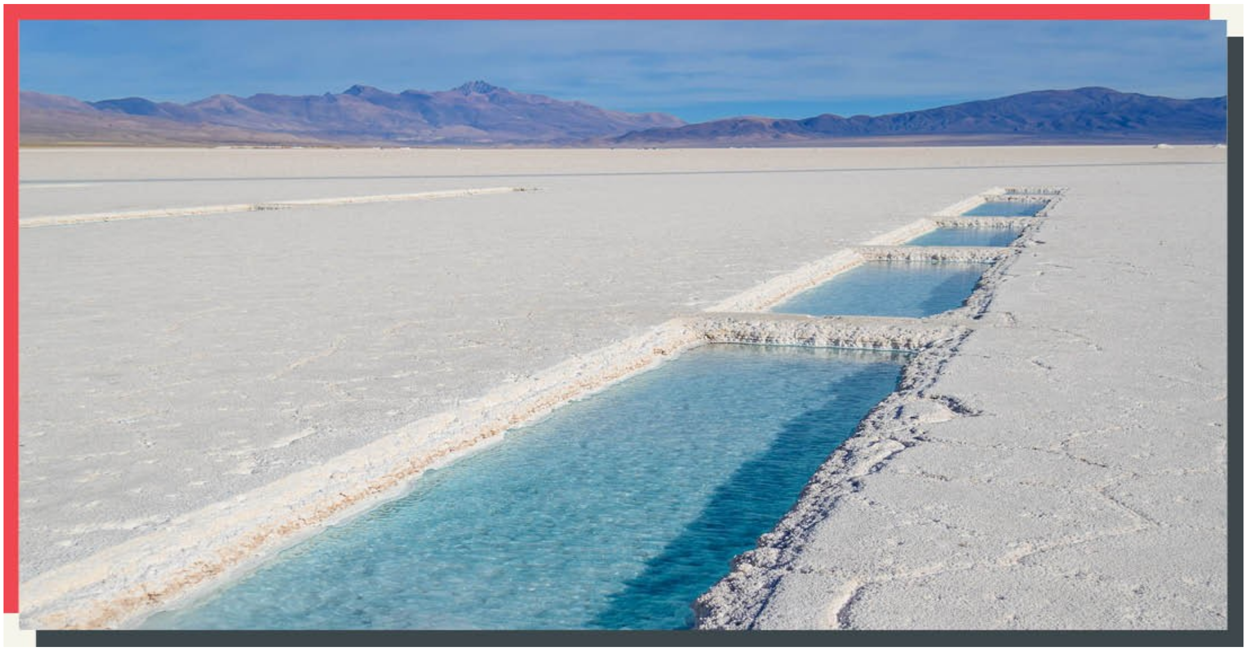

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Introduction

Over the last few years, foreign-operated mines and patent holders have faced significant political risks globally. In parts of Africa, Latin America, and Southeast Asia, governments are restricting the export of raw minerals, demanding that miners build processing plants locally, and looking to tighten control over foreign-operated mines.[1] Recently, the US Secretary of Commerce publicly stated that China has become "uninvestible" for United States companies, pointing to various measures taken by China that have made it risky to do business there.[2] One such notable "lawfare offensive" adopted by China is the use of its courts to nab Western technology by nullifying patents in industries it deems important, including pharmaceutical, technology, and rare-earth minerals. Indeed, several Western companies have expressed serious concerns about patent invalidation in China, and they have noted "a tendency of court rulings to favor Chinese stakeholders when strategic sectors or companies, in particular state-owned enterprises, are concerned."[3]

In the midst of these growing political risks, what tools do foreign companies have to protect their investments? One such tool is the use of international investment treaties. There are over 2,000 Bilateral Investment Treaties that are currently in force worldwide. There are also a number of multilateral treaties, including chapters of Free trade Agreements, containing similar investment-related obligations. Many of these treaties provide substantive guarantees to protect investments and entitle an investor to seek recourse directly against the host state in arbitration before an international tribunal under international law. Such a procedure often offers substantially more effective remedies than claims before local courts or tribunals.

This note provides a brief overview of investment treaties and explains the importance of the protections they offer to foreign investors and their investments (such as patents, concession agreements, contracts, etc.) and the advantages of their dispute settlement mechanisms.

Are You Protected By An Investment Treaty From Political Risks?

With growing resource nationalism and other political risks globally, it is important to assess whether you are able to even take the benefit of such a treaty. Investment treaties protect an investor who is a national of a state that has an applicable treaty with the host state. Generally, all natural and legal persons that possess the nationality of another contracting state can be considered "investors" for the purpose of the treaty. The investor must have the nationality of a state other than the host state. For example, if you are a US investor with an investment in Mexico, you may be able to benefit from the United States-Mexico-Canada Agreement or USMCA.

However, in the event you are not able to seek recourse under a treaty, you could still consider restructuring your investment well in advance of a potential dispute to be able to later seek protection under a treaty. Otherwise, the tribunal may dismiss the claim. For example, in the *Phoenix Action, Ltd. v. Czech Republic* case, the shares in two domestic Czech entities were transferred to an Israeli corporation only after the Czech companies had become embroiled in domestic disputes and litigation with the public authorities, including criminal proceedings. The tribunal concluded that the purpose of the restructuring was solely to bring an investment treaty claim under the treaty and, therefore, dismissed the claim.

Do Investment Treaties Protect Your Investment?

The next step is to understand if your investment is protected under an investment treaty. Treaties differ with respect to the definition of protected investments. Most treaties, however, contain broad definitions of various types of assets as well as a non-exhaustive list which encompasses tangible and intangible assets. For example, protected investments include: an enterprise, shares, stock, and other forms of participation in a company; bonds, debentures, and other forms of debt in a company; rights under a contract; intellectual property rights and goodwill concessions, licenses, and authorizations; claims to money and performance under a contract having a financial value.

What Types of Substantive Protections Are Available Under Investment Treaties?

Investment treaties provide covered investors and their qualifying investments with a number of protections independent of the municipal law that governs a project or other investment. These are state commitments with respect to the treatment of foreign investments made in their territory.

While specific protections vary in each treaty, the following are the core protections included in most investment treaties:

- **Expropriation:** Expropriation is the taking of private property made by the state for a public purpose. A state can expropriate physical assets, like a factory or a mine, and intangible rights, such as intellectual property, contractual rights, or shares in a company. Notably, expropriation need not necessarily be the active taking of foreign property by a state through a direct act. A state may unlawfully expropriate a foreign investment if it takes measures that gradually decrease its value until the investment is virtually worthless and the state does not compensate the investor for these losses. In the recent case of *Michael Anthony Lee-Chin v. Dominican Republic*, for example, the dispute arose after the state took over a landfill project belonging to the investor following alleged environmental and sanitary issues. The tribunal found that the state had unlawfully expropriated the investor's rights to operate the landfill, which stemmed from a concession agreement.
- **Fair and equitable treatment:** This protection forbids states from treating investors and their investments in an arbitrary, discriminatory, and unjust manner. Likewise, under this standard,

states must refrain from breaching the reasonable and legitimate expectations that caused the investor to make the investment. A state will be found to have breached the fair and equitable treatment standard if its conduct lacks respect for due process or the state's regulatory framework. For instance, a state may breach the fair and equitable treatment standard if it arbitrarily targets a foreign investor and their investment with measures such as baseless investigations or fines. A state may also breach this standard if it adopts regulatory measures that do not follow basic principles of due process like the right to be heard or to challenge a measure. In *Cairn Energy v. India*, for instance, the dispute arose after the state decided to retroactively apply a new tax code to transactions the investor has made six years before the new law entered into force. In deciding that the state had breached the Fair and Equitable standard of treatment, the tribunal noted that the tax-related measures impaired the principle of stability and predictability and were grossly unfair.

- **Full protection and security:** States are obligated to provide investors and their investments with physical safety. States must also ensure that they maintain stable legal and business environments. Conduct that breaches the full protection and security standard is often related to the failure to protect an investor and their investment against physical violence caused by riots or social turmoil. A state may also breach this standard if state agents unlawfully detain or otherwise physically harm a foreign investor. In *AMT v. Zaire,* for example, state soldiers looted and destroyed the investor's property during riots and social upheaval in Zaire's capital. In finding that the state breached the full protection and security standard, the tribunal noted that Zaire had taken no measures to protect the investor's property and had failed to observe a basic obligation of vigilance.
- **Most favored nation treatment:** This protection guarantees that the state will provide the investor with the same treatment it affords investors of a third country under a separate investment treaty. In practice, a most favored nation clause in a treaty may allow an investor to rely on a state's more favorable treaty commitment with other states and its nationals. For example, if a treaty does not contain protection against full protection and security, but the state where the investor was made has a treaty with a third country that does contain such protection, the investor may be able to import the full protection and security standard using the most favored nation clause. In *MTD v. Chile*, for instance, the investor filed a claim under the Malaysia-Chile BIT, which included more limited protections than those afforded by Chile to nationals of third countries under other treaties. Using the most favored nation clause in the BIT, the investor imported several substantive protections from treaties that Chile had in force with Croatia and Denmark. The tribunal ultimately accepted the invocation of the most favored nation clause and held Chile under the most expansive standard of treatment it had committed to in the other treaties.
- **National treatment:** Like the most favored nation treatment, this standard seeks to prevent discrimination on the basis of nationality. This protection requires that the state treats the foreign investor the same way it treats its own nationals. An example of a breach of national treatment may occur when a state takes a measure that restricts the operation of foreign investments in a certain industry that does not affect its nationals' investments in the same industry. In *Cargill v. Mexico*, for example, a dispute arose over a 20% tax levied by the state on soft drink bottlers who used a specific type of sweetener; the state introduced the tax at a time when the sweetener was rapidly taking over the local market while the local sugar industry struggled. The tribunal found that the state breached the national treatment standard because it taxed the products containing the sweetener to pressure the U.S.—the country of the investor's nationality—to help resolve Mexico's sugar-related grievances.
- **Free Transfer:** Through this protection, states guarantee that the investor will be allowed to freely transfer the funds related to and resulting from the operation of its investment to the investor's home country. Investors are also guaranteed the conversion of funds into the currency of their preference. In *Air Canada v. Venezuela*, for example, the dispute concerned Air Canada's operation in Venezuela and the difficulties it experienced in repatriating funds after the state created an agency in charge of administering exchanges to foreign currency. In short, the state agency did not approve the investor's request for exchange and transfer of its funds, which led Air Canada to suspend its operations. The tribunal found the state breached the free transfer of

funds obligation by failing to process Air Canada's requests for exchange and transfer of funds in a manner consistent with past practice.

The strategy an investor pursues with respect to their investments in a foreign country will depend on the specific set of facts relevant to their dispute and the rights available to them. But investors are well-advised to take proactive measures to protect their rights and business interests to anticipate any disruptions to their investments. Investors should consult with experts to assess how to best achieve these goals.

How Investment Treaty Disputes Are Resolved

One of the most important features of investment treaties is that they give investors a direct right of action to bring international arbitration claims against states. The object of this action is to enforce the treaty's substantive protections against the state host to the investments. Notably, the investor need not have a direct contractual relationship with the state to bring these claims. The specifics of this legal action are set out in the treaty's dispute resolution clause.

The dispute resolution clause normally requires the investor to provide written notice of the existence of a dispute to the state. The notice triggers a so-called "cooling off period" that normally lasts between three and six months. During this period, the investor and the state are required to engage in efforts to settle the dispute. If no settlement is reached, the investor can submit the dispute to arbitration.

Treaties typically offer investors multiple forums for submitting arbitration claims. These include the (i) International Centre for the Settlement of Investment Disputes ("ICSID"), a body of the World Bank in Washington, D.C., (ii) *ad hoc* arbitration under the arbitration rules of the United Nations Commission on International Trade Law, and (iii) private institutions like the International Chamber of Commerce or the Stockholm Chamber of Commerce.

Once the arbitration is underway, the process will usually entail discussions on the tribunal's jurisdiction over the investor's claims and the merits of the dispute. These phases include one or more substantive hearings. The arbitrators will issue an award that will need to be enforced under certain international treaties and can only be annulled on limited grounds.

Investment Treaties as a Tool to Obtain a Favorable Settlement

You may consider using your treaty rights as leverage for negotiating an amicable resolution to the dispute through a settlement. Numerous examples exist where investors have notified the host state of the existence of a dispute, and the parties subsequently reached an amicable settlement.

- In 2019, Uber notified Colombia of an investment dispute under the Colombia-U.S. trade promotion agreement. The conflict arose when Colombia banned Uber's ride-hailing services in the country. Three months after serving the notice, however, Uber re-entered the country with a new car rental service, and only six months later, the Superior Tribunal of Bogota annulled the initial order that had banned Uber.
- In 2016, Swiss pharmaceutical company Novartis threatened to bring an arbitration against Colombia under the Switzerland-Colombia bilateral investment treaty. Novartis's threat stemmed from Colombia's announcement to impose price controls on a patented treatment for leukemia, which would force Novartis to lower the price of one of its drugs. After Novartis threatened to pursue arbitration, however, Colombia backtracked on its plans to issue the license.
- In 2017, the company Grenada Private Power brought an arbitration against Grenada under a share purchase agreement after the state declared its intent not to comply with its contractual obligations. In the arbitration, the investor asked the tribunal to order Grenada to repurchase the shares it had acquired. The parties, however, settled the dispute during the arbitration by concluding a supplementary contract. Later, when the state breached this new contract, the

investor brought a second arbitration against Grenada. In the new proceeding, the arbitral tribunal ordered the state to comply with its contractual obligations and repurchase the shares from the investor.
- A recent example of another dispute settled during the arbitration is the case between autoTicket—a joint venture between German and Austrian companies—and Germany. The dispute concerned contracts for the implementation of a passenger-vehicle toll that the state terminated. The investors brought arbitration claims against Germany. Ruling on the merits, the tribunal found that the state had breached the contracts but reserved the quantification of damages. In the meantime, both parties settled the dispute, with the state paying the investors 243 million Euros in compensation.

These cases show that a dispute under an investment treaty can be a useful tool to pressure the state to negotiate a settlement.

We at Selendy Gay would be delighted to assist you in your investment treaty planning–to help you get in front of any potential disputes–and assess any potential claims.

[1] "Mineral-Rich Developing Nations Demand Bigger Piece of the EV Pie, *The WSJ*, July 1, 2023

[2] https://www.reuters.com/markets/china-response-uss-raimondo-says-it-is-easing-market-access-foreign-firms-2023-08-30/.

[3] https://www.wsj.com/articles/u-s-china-technology-disputes-intellectual-property-europe-e749a72e.

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