Investor-State arbitration - Protecting investments before it is too late

The economic opportunities of investing abroad are undeniable. Unfortunately, so are the political, legal and regulatory risks associated with foreign investments. Investors should carefully assess their exposure to those risks. They should plan in advance how to hedge against State interference. Public international law can help foreign investors to maximise their protection against such risks.

There are over 3,000 treaties in force that provide legal protection to foreign investments (international investment agreements or "**IIAs**"). IIAs include both bilateral investment treaties ("**BIT**") and free trade agreements ("**FTA**"). A BIT is an agreement between two States to protect investments made by nationals of one contracting party in the territory of the other contracting party. An FTA is an agreement between two or more States that seeks to eliminate barriers to international trade and promote foreign direct investment.

IIAs generally provide for substantive legal protections such as:

(a) Protection against "**illegal expropriation**", including direct expropriation (where the State takes the legal title of the foreign investor's property) and indirect expropriation (where the State's actions deprive the foreign investor of the possibility of utilising the investment in a meaningful way, even if the investor retains legal title and control);

(b) "**Fair and equitable treatment**", which involves principles of good faith, the protection of legitimate expectations, transparency, protections against denial of justice and prohibitions of discrimination and unreasonable conduct;

(c) Prohibitions on more favourable "**national treatment**" and a guarantee of "**most-favoured nation**" treatment, which are expressions of the non-discrimination principle. The national treatment standard requires a host State to treat foreign investors and their investments no less favourably than how it treats domestic investors and investments. The most-favoured nation standard allows a foreign investor to rely on any more favourable substantive protections offered to the investors of any third State;

(d) "**Full protection and security**", which requires a host State to take reasonable measures to protect investments and investors against physical or legal interference, either by the State or by third parties; and

(e) An "**umbrella clause**", whereby the obligations of the State with respect to an investment (for example, contractual obligations) are automatically incorporated into an IIA.

To enforce these substantive legal protections, most IIAs also provide for investor-State dispute settlement ("**ISDS**"). This allows investors to initiate international arbitration proceedings directly against a State in the event of a dispute. The ISDS mechanism provides an investor with access to an independent and international panel of experts (arbitrators) to adjudicate the dispute. These panels have the authority to issue final and binding awards that settle the

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dispute between the parties. ISDS is characterised by its high rate of compliance by the losing party. In recent times, however, a number of States have refused voluntarily to satisfy adverse arbitral awards. But this need not prevent a claimant investor from collecting the compensation to which it is entitled. Arbitral awards are generally enforceable under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention"), the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") and the Inter-American Convention on International Commercial Arbitration (the "Panama Convention").

Foreign investors have successfully invoked IIAs to obtain awards, compensation and settlements of hundreds of millions, or billions, of dollars. These include expropriation cases against Argentina; claims by shareholders in Yukos against the Russian Federation; and awards against Venezuela obtained by subsidiaries of Owens-Illinois and Koch Industries, represented by Volterra Fietta.

Although IIAs often share common characteristics, each agreement has specific language (sometimes subtle and nuanced). Therefore, IIAs must be individually and carefully scrutinised on their own terms. Investors who find that their investments are not entitled to the protections of a treaty – or are subject to a treaty that does not provide optimal legal protection – can (and often should) plan ahead.

A key element of planning foreign investments is discerning the degree of legal and regulatory protection granted to an investment in the host country. This process encompasses not only understanding the legal and regulatory risks of investing in the host country as a matter of local law, but also, as a matter of international law. Investors should confirm whether their present or future investments are, or may be, covered by an IIA.

Similarly to tax planning, well-advised investors prepare against State conduct by structuring their investments in ways that maximise their protections under an IIA. For example, if a company is not incorporated in a country that has a BIT with the country where it plans to invest, that company might want to restructure its investment through a subsidiary that is protected under an IIA to which the host State of the investment is a party.

Investors should pay particular attention to the timing of the restructuring. Indeed, a number of arbitral tribunals have concluded that investors cannot restructure their investments with the sole purpose of benefiting from IIA protection once the disputed conduct has occurred. As a practical consequence, this means that an investor should review the status of its foreign investments under IIAs before a dispute with a host State arises. Pre-emptive action can save millions of dollars to foreign investors.