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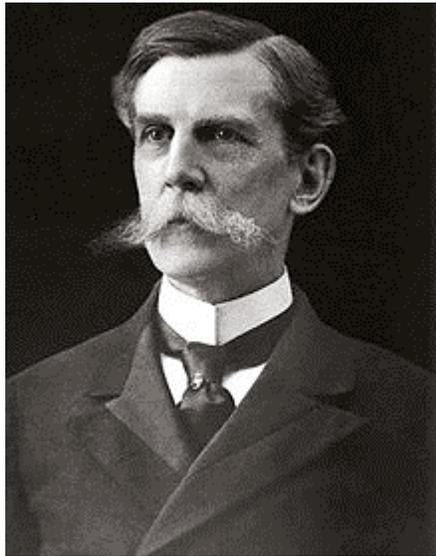
# State Contracts, Investment Risk, and Bilateral Investment Treaties: A Primer for Transactional Lawyers

*Charles T. Kotuby Jr.*

**“Men must turn square corners when they deal with the Government.”**

Oliver Wendell Holmes, Jr.

*Rock Island, A. & L. R. v. United States*, 254 U.S. 141, 143 (1920).



**JONES  
DAY**

# Contracting with Sovereign Entities

- *“The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character.” (Article 4, Draft Articles on State Responsibility)*
- *“The conduct of a person or entity which . . . is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.”(Article 5, Draft Articles on State Responsibility)*

# Arbitrating with Sovereign Entities

- Ordinary commercial arbitration mechanisms may be used in state contracts, and are especially common in petroleum, mining and infrastructure projects.
- AAA/ICDR, ICC, SCC, LCIA, UNCITRAL and even ICSID may be used for state contract disputes.
- Arbitrability can be challenged at the outset by a state wishing to revoke its consent
- Enforcement of awards, under the New York Convention, depends on municipal law and (sometimes) parochial policies

# Arbitrating with Sovereign Entities

Looking “Down the Road” to the Enforcement of an Arbitration Award.

- Who Is Your Contracting Partner? *Avoid nominal labels*
- What Is The Likelihood Of Home-State Enforcement? *Be realistic*
- Are there Assets Elsewhere? *And will foreign courts let you get them?*
- Waiver Of Sovereign Immunity Clause?



# Arbitrating with Sovereign Entities

*[Party] hereby unconditionally and irrevocably agrees that:*

- *The making and performance of this [Contract] constitutes private and commercial acts rather than public or governmental acts;*
- *Should any legal proceedings be brought against it or its assets in relation to this [Contract] or any transaction contemplated by this [Contract] no immunity (sovereign or otherwise) from such legal proceedings shall be claimed by or on behalf of itself or with respect to its assets;*
- *Waives any such right of immunity (sovereign or otherwise) which it or its assets have in any jurisdiction; and consents generally in respect of the enforcement of any judgment or arbitral award against it in any such proceedings to the giving of any relief or the issue of any process in connection with such proceedings.*



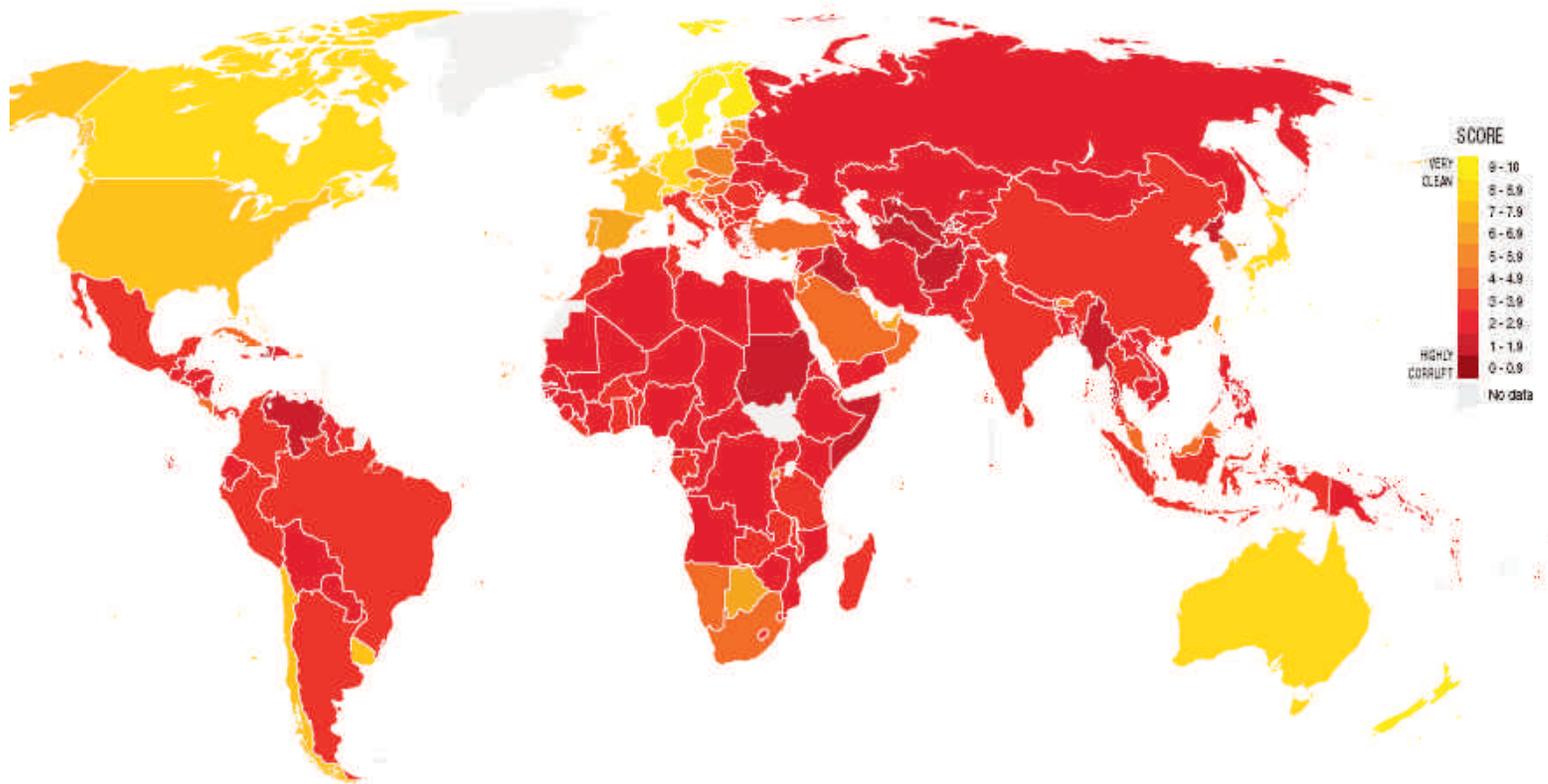
# Mitigating Investment Risk

“We seem to live in a wonderful world. Or so it seems, that is, when one considers that States all over the world unhesitatingly . . . proclaim[] [themselves] to be un *Estado de derecho* . . . . This vision is an illusion. Worse, it is a fraud. . . . The error is to think that injustice is abnormal. It may be more realistic to think and act on the assumption that justice is a surprising anomaly.”

Jan Paulsson, *Enclaves of Justice*



# Mitigating Investment Risk



Transparency International, *Corruption Perceptions Index* (2012)



# Protection Without Privity: Bilateral Investment Treaties

- BITs are agreements between states where each undertakes to treat the investors of the other state in accordance with international law.
- They typically include a compulsory clause for the settlement of disputes which arise between a signatory state and those foreign investors.
- In the words of one U.S. court, “[a]ll that is necessary to form an agreement to arbitrate is for one party to be a BIT signatory and the other to consent to arbitration of an investment dispute in accordance with the Treaty’s terms. In effect, [the State’s] accession to the Treaty constitutes a standing offer to arbitrate disputes covered by the Treaty; a foreign investor’s written demand for arbitration completes the ‘agreement in writing’ to submit the dispute to arbitration.” *Rep. of Ecuador v. Chevron*, 638 F.3d 384, 392 (2d Cir. 2011).



# Protection Without Privity: Bilateral Investment Treaties

- *As with commercial arbitration*, dispute is removed from national courts, thus removing possible bias and lack of capacity to handle complex cases
- The arbitration typically occurred before an *ad hoc* Tribunal under the UNCITRAL Rules, or at the International Center for the Settlement of Investment Disputes (“ICSID”).
- Over 3,000 BITs in Force
- Multilateral agreements Relevant to Oil and Gas Industry (e.g. NAFTA, Energy Charter Treaty, South African Development Community Investment Protocol)



# Protection Without Privity: Bilateral Investment Treaties

*In some ways, BITs provide narrower protection than commercial arbitration*

They typically cover “investment disputes”?

- Disputes concerning “every kind of asset,” e.g. licenses, concession and contract rights, shares, real property

*So long as . . .*

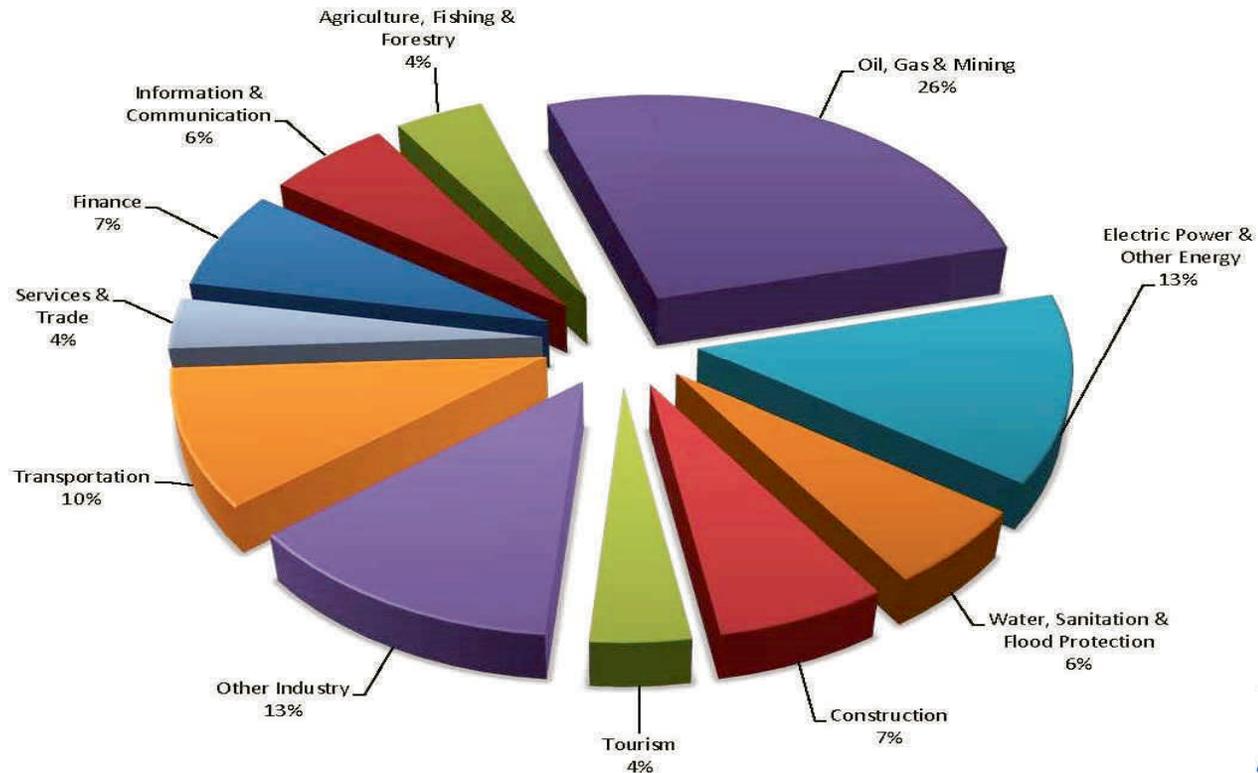
- There is also an associated influx of capital, a permanency of operations, investment risk and the expectation of long-term profits



# Protection Without Privity: Bilateral Investment Treaties

## 6. Distribution of All ICSID Cases, by Economic Sector

Chart 7: Distribution of All Cases Registered under the ICSID Convention and Additional Facility Rules, by Economic Sector\*:



\*This sector classification is based on the World Bank's sector codes, available at <http://siteresources.worldbank.org/PROJECTS/Resources/SectorCodesLists.pdf>.

# Protection Without Privity: Bilateral Investment Treaties

*In some ways, BITs provide broader protection than commercial arbitration*

- Unlike commercial arbitration, consent is practically irrevocable and difficult to challenge.
- ICSID provides a stronger enforcement regime, divorced from municipal law and parochial national policies.
- BITs don't just protect against breaches, but also against various forms of *political risk*



# Protection Without Privity: Bilateral Investment Treaties

- Uncompensated expropriation
- Arbitrary or discriminatory measures
- National and most-favored-nation treatment
- Fair and equitable treatment
- Full Protection and security
- Free transfer of funds
- The “Umbrella Clause”

# Drafting State Contracts and the “Umbrella Clause”

- Dates back almost a century (*UK-Peru Treaty on Mineral Property* (1921))
- Broadly Worded Protection: “Each Contracting Party shall observe any obligation it enters into with regard to investments of nationals of the other Contracting Party.” *Neth.-Kazakh. BIT, Art. 3(4)*.
- A breach of contract by a State (or other sovereign actor) may be a breach of a treaty, too, depending on the sovereign or commercial nature of the breach



# Drafting State Contracts and the “Umbrella Clause”

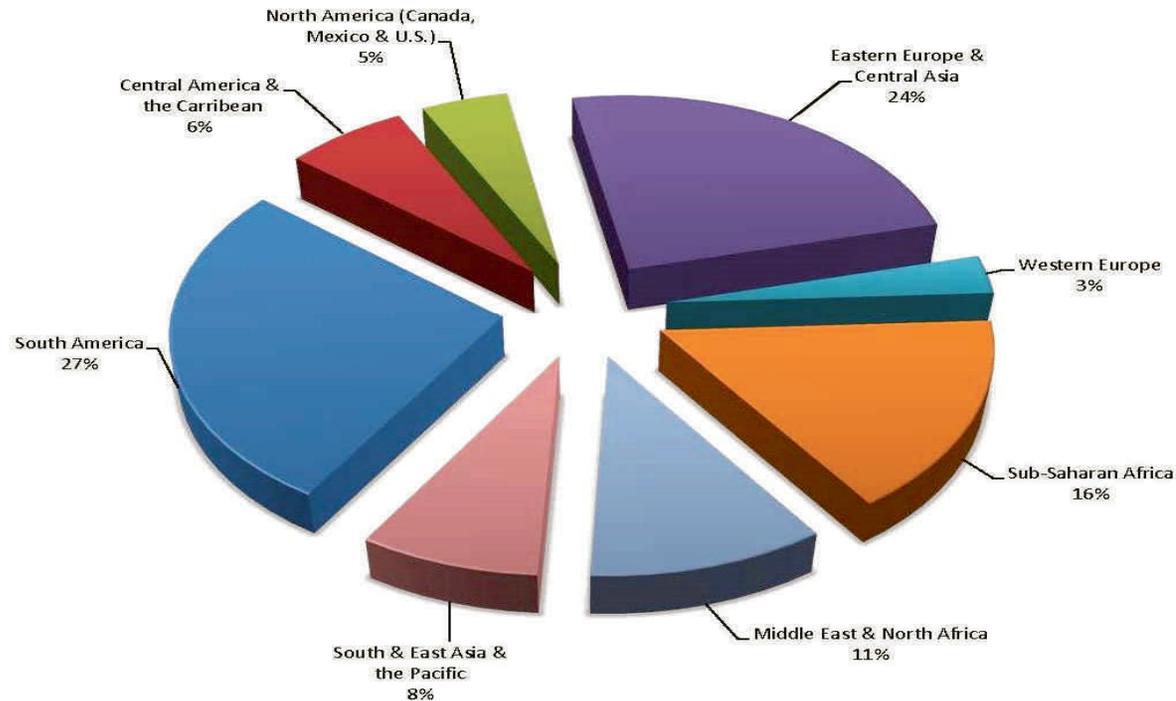
## Some Practical Advice:

- Know the capacity of your contracting partner. *Is it the state itself, or an SOE? Is its performance grounded in its commercial or sovereign capacity? What type of risks are associated with the contract?*
- The “Fork in the Road”: *Does the BIT preclude resort to other dispute resolution mechanisms?*

# Obtaining BIT Protection

## 5. Geographic Distribution of All ICSID Cases, by State Party Involved

**Chart 6:** Geographic Distribution of All Cases Registered under the ICSID Convention and Additional Facility Rules, by State Party Involved\*:



\*The classification of the geographic regions above is based on the World Bank's regional system, available at <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/0,,pagePK:180619~theSitePK:136917,00.html>, and also includes World Bank donor countries.

# Obtaining BIT Protection

- BIT protections only apply to “*nationals*” of a contracting state, which is typically determined by citizenship or place of incorporation
- Canada has BITs with 30 other States, but . . .
  - Only 4 of those are with top-25 oil producing states (United States, Mexico, Russia and Venezuela)
  - It has only 1 BIT in force with an African State (Tanzania)
  - None of its BITs have an umbrella clause

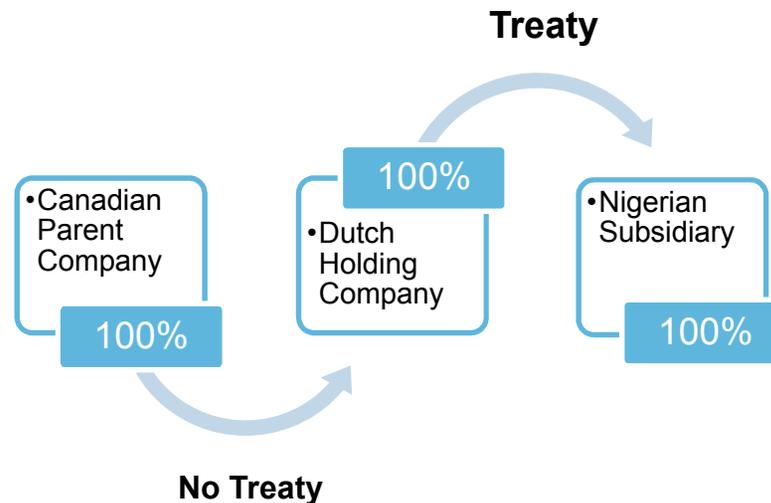


# Obtaining BIT Protection

- Most BITs also protect both “direct and indirect” investments.
- A company without treaty protection in its home jurisdiction, or with inadequate protection, can structure (or even restructure) the ownership of its foreign investments to secure maximum protection under existing treaties

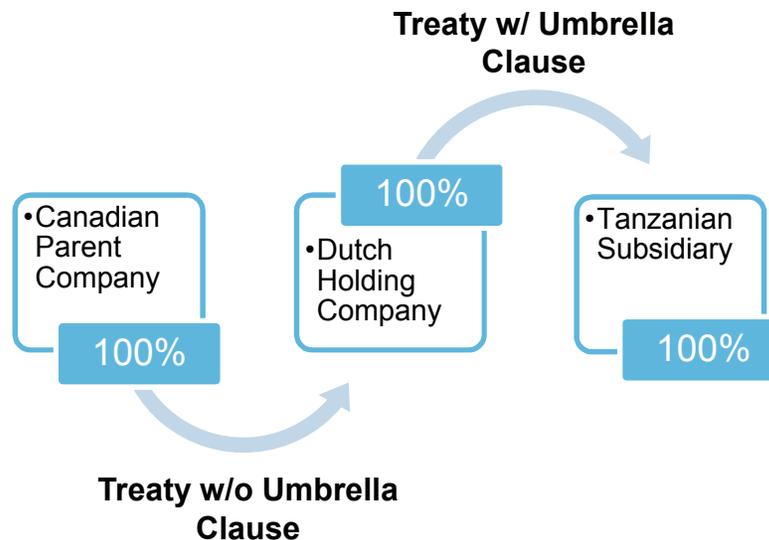
# Obtaining BIT Protection

So, a Canadian company contemplating an investment in Nigeria will route that investment through a Dutch holding company, thereby protecting it under the Netherlands-Nigerian BIT.



# Obtaining BIT Protection

The same can be done to upgrade treaty protections: A Canadian investor in Tanzania can route its investment through a Dutch subsidiary to take advantage of the umbrella clause that appears in that treaty.



# Obtaining BIT Protection

- This sort of proactive planning for treaty protections is, according to one recent Tribunal, “not unusual nor is there anything in the least reprehensible about it.” *HICEE v Slovak Republic*, UNCITRAL (23 May 2011) ¶ 103.
- The only qualification is that the structure has to be in place *before* the dispute arises—a prospective claimant cannot restructure his investment for the sole purpose of bringing an investment claim. See *Phoenix Action Ltd. v. Czech Republic*, ICSID (April 15, 2009), ¶¶ 140-42.

## “Investment Havens”

- An investor must consider a number of factors when structuring a foreign investment, including,
  - Tax Treatment
  - Ease of Establishment
  - Stability and Political Risk
- The existence and terms of an investment treaty is another important consideration

# “Investment Havens”

Jurisdiction	# of Tax Treaties in Force	Overall Regulatory Quality Ranking <sup>1</sup>	# of BITs in Force
Belgium	92	86 <sup>th</sup> Percentile	66
Hong Kong	28	100 <sup>th</sup> Percentile	15
Luxembourg	68	96 <sup>th</sup> Percentile	66
Mauritius	39	79 <sup>th</sup> Percentile	21
Netherlands	93	97 <sup>th</sup> Percentile	90
Singapore	73	100% Percentile	38
Spain	85	79 <sup>th</sup> Percentile	70
United Kingdom	121	96 <sup>th</sup> Percentile	96

## Protection Without Privity: National Investment Laws

- National legislation can expressly protect foreign investment, too.
- Investment Laws can include a unilateral consent to international arbitration, most often before an *ad hoc* UNCITRAL tribunal or even at ICSID
- Nationality is not an issue for jurisdiction
- But protections and scope of consent can be vague, idiosyncratic, and subject to municipal law.

## Protection Without Privity: National Investment Laws

Sometimes, proactive diligence is still required to access investment protections and international arbitration.

- In *Botswana*, an investor must provide reciprocal consent to international arbitration vis-a-vis the state within one year of making an investment
- In *Namibia*, *Ivory Coast*, *Mauritania*, and the *Central African Republic*, the investor must affirmatively opt for arbitration in its investment license or certificate.



# Conclusions

The complexities of dealing with sovereign parties requires:

- Careful diligence into the capacity and authority of your contracting partner
- Careful drafting of to allow for enforceable remedies in the event of a breach
- Updated knowledge of local country conditions
- Proactive planning to unilaterally protect one's investment

