Recent Developments in Investment Treaty Arbitration

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Introduction

Investment Protection

In the early phase of the development of energy projects, an essential factor in making a decision to pursue the particular project is the political and investment risk of a country. Investors and their lenders will usually establish as part of their due diligence process whether there is an investment treaty in place between the investor's home country and the country where the project is situated.

These treaties usually follow a standard form and are primarily designed to promote foreign investment by offering the investor protection for any assets acquired, minimising loss and risk in the case of expropriation and providing a framework for dispute settlement. The main type of investment treaty offering this protection is a bilateral investment treaty between two countries ("BIT"), although inter-regional and multi-lateral treaties also exist (as do sector specific treaties such as the Energy Charter Treaty).

Several African governments have encouraged investment on the continent by entering into BITs or otherwise adopting arbitration legislation. A full list of all BITs in force can be found at www.worldbank.org/icsid.

What do Bilateral Investment Treaties do?

BITs usually contain provisions on:

- the right of entry of nationals and the establishment of a company in the other party's country;
- the unrestricted repatriation of capital, property and other assets;
- conditions relating to expropriation and nationalisation (which should be non-discriminatory and with fair compensation);
- most-favoured-nation treatment (where one country treats investments of the other country's nationals no less favourably than its own nationals);
- the levels of damages or compensation available (e.g. due to war, national emergency and riots); and
- a guarantee of due process of law.

Each of these areas is an important factor to consider when dealing with foreign direct investments in developing countries, particularly when considering the strength of termination compensation provisions in project documents as well as the level of political risk insurance that may be required.

Where do parties submit to arbitration?

BITs usually include a provision stating that the government will allow international arbitration of any dispute between it and a national of the other treaty country. Often the treaty may offer a range of arbitral options.

States usually submit to ICSID, the International Centre for the Settlement of Investment Disputes, a World Bank sponsored institution, because these arbitrations are not subject to the procedural laws of any particular state.

Arbitration and BITs in Africa

Non-African investors may be reluctant to have the seat of arbitration in Africa (and likewise African counterparties may not want to travel outside the continent to arbitrate). It is also possible that a BIT provides for hearings for arbitration to be held in the relevant African host state - provided the mandatory laws of procedure of such host state do not interfere in arbitration proceedings.

As stated above, many African countries have entered into BITs and adopted arbitration legislation in accordance with the UNCITRAL model law on international commercial arbitration (for example, Nigeria).

Arbitration can always be held ad hoc or under an institutional arbitration body. The main institutional arbitration centres in Africa that are internationally recognised are the Cairo Regional Centre for International Commercial Arbitration, the Lagos Regional Centre for International Commercial Arbitration and the Arbitration Foundation of South Africa.

The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, has been ratified by the majority of African states (including the three largest economic centres of Egypt, Nigeria and South Africa). However, many have not ratified the convention. Some countries that have ratified (such as Nigeria) have also made the permitted reservations as to reciprocity and commercial relationships. This means that it is essential to consider enforcement issues if choosing the seat in Africa.

In addition, the OHADA Uniform Act on Arbitration was adopted in 1998, along with the arbitration regulations of the Common Court of Justice and of Arbitration ("CCJA"). Countries such as Benin and Mali have cases pending at the CCJA. During its first five years of operation, the CCJA received 162 cases with 44 decisions and 7 opinions released. OHADA has also created a regional training centre for legal offices (known as ERSUMA) to train judges and lawyers in OHADA law. The hope is that the CCJA's use can be expanded by its members as a result of better training amongst lawyers in the profession.

Recent developments in the energy sector

Recent arbitral awards have made interesting reading for investors and their lenders, although it is worth expressly noting that international arbitral decisions, unlike court decisions in common law jurisdictions, do not have a system of precedent and that tribunals are under no obligation to adopt previous tribunals' approaches.

An arbitral award handed down by an UNCITRAL tribunal in proceedings brought by the UK energy giant National Grid PLC (against the Republic of Argentina) was published earlier this year. The tribunal found the Republic of Argentina liable to National Grid for damages totalling more than US$53 million. This sum was compensation for the devaluation of National Grid's investment in the Argentine electricity transmission system as a result of legislation amended by the Argentine Republic in 2001-2002 which had the effect of revoking National Grid's right to calculating its tariffs in US dollars and converted the remuneration due to the National Grid company into Argentine pesos at the artificial rate of one peso to one US dollar.

National Grid argued that Argentina had treated its investment unfairly and inequitably and failed to provide its investment protection and constant security. On these grounds, the tribunal found that Argentina had breached the standards it owed to the claimant's investment under the UK-Argentina BIT.

Argentina's defence had centred around the fact that the measures it had taken in amending its convertibility laws were taken in response to a "state of necessity" (as defined under the Draft Articles on State Responsibility). The tribunal held that fiscal policies and labour market rigidity (as well as external debt) were contributing factors to the Argentine crisis of 2001-2002, and that these were within the control of the Argentine government and that therefore Argentina had contributed to the state of necessity. The "state of necessity" defence may not be invoked if the State has contributed to the situation of necessity and so the Argentine defence failed.

The National Grid decision seems to give a positive message to investors, particularly in the energy sector in emerging markets that in these times of economic difficulties, a government's actions that adversely affect foreign investments might not be defended on the grounds of "necessity". Although ultimately each arbitration turns on the evidence presented to the tribunal at the time, awards by highly regarded tribunals are sure to be persuasive in subsequent similar claims. In that regard, this decision gives an encouraging sign to investors.

Since states are free to negotiate their BITs by broadening the scope of the defences available to them (e.g. states could draft in a defence of national security), investors are advised to seek expert advice to check the relevant BIT very carefully to ensure that their investments are adequately protected.

Who is the investor? Piercing the corporate veil

Another area to look at when analysing the protection offered by a BIT is the nationality of the investor. BITs usually define an investor's nationality according to the place of its incorporation. Under a recent case, even though the claimant met the criteria specified by the BIT (i.e. it was incorporated in the treaty country), the tribunal held that it did not meet the ICSID Convention's independent objective standard of "foreign control" (the tribunal looked to ultimate ownership and the make-up of its board of directors).

This is a move away from tribunals' reluctance to look to the ultimate ownership of investments and is highly relevant for tax-driven or offshore investments. The important thing to note

is that just because an investor may think that they are covered under a treaty, this is not wholly determinative as, for example, ICSID can look at external factors in assessing nationality.

Conclusions

In the light of this movement in the landscape of investment treaties, we set out below a list of key points to bear in mind when reviewing whether a BIT or other investment treaty gives an adequate level of protection to an investor:

(a) Nationality of the investor and the investment

Take the example of a Dutch based oil company investing in an LNG plant in a Western African nation. There may be a BIT between the Netherlands and the Western African nation, but for tax reasons, the project company making the investment may be incorporated offshore. Whether or not the offshore entity qualifies for the BIT protection will be a matter of fact and interpretation of the definition of "investor" under the relevant BIT. The starting position will be a strict interpretation of where the company seeking protection is incorporated.

There is increasing opposition to the use of "letter-box" companies in jurisdictions which establish domicile for tax reasons and to claim BIT protection. An investor should always be advised of this risk as an arbitral tribunal may look behind the corporate structure to see whether an investor or investment is truly from the country party to the BIT.

(b) Enforcement and time taken

The National Grid case shows that it can take several years to get an award (and even longer to have one enforced). The courts of a country that is a signatory to the New York Convention should enforce an arbitral award. However, there is always a risk with international arbitration that a claimant may have difficulty in enforcing an award.

Significant resources may have to be spent before an award is enforced. One should always consider the procedural law of the country in which enforcement is being sought before proceeding with enforcing an award.

(c) Choice of arbitral tribunal

Investors and their financiers should always ensure that they receive specialist arbitration advice on whether arbitration should be ad hoc or administered and whether it should be carried out under the auspices of a particular arbitration institution (e.g. ICSID or UNCITRAL). The enforceability of the award, jurisdictional objections available to respondents, the availability of interim measures and confidentiality concerns will all be relevant factors that need to be analysed before advising an investor on the appropriate course of action.

It is worth noting that certain emerging markets (such as Bolivia) have recently denounced the ICSID convention, particularly in relation to natural resources.

(d) Lenders and investors' rights to protection

Investors' financiers often seek advice as to whether they count as "investors" and whether loans count as "investments" under investment treaties, thus affording loan protection. The answer to this depends on the specific drafting of the definitions in the BIT, but in many instances lenders have become comfortable with protection offered to the investor itself, given the investor should be obliged to apply any compensation

proceeds to repay the loan. Lenders also have comfort if the borrower retains offshore accounts to repatriate funds (which are allowed under most investment treaties).

It should be noted that in order that the BIT comes into operation on behalf of the lender or investor, there must be a contract containing an arbitration clause between the lender or investor and the state it is intending to bring to arbitration. This is because BITs themselves are between two states and may automatically confer direct benefits or rights on private individuals, who traditionally do not enjoy having full legal personality under international law.

(e) Political risk insurance ("PRI")

Finally, PRI is a good way of mitigating political risk and should always be considered, although it may not be deemed to be a cost-effective solution.