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Using BITs to Protect a Company's Foreign Assets

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Over the past few decades, companies—both large and small—have increasingly become reliant on a dual-track global business model. In essence, many companies now depend on foreign sales to boost their bottom line, while simultaneously seeking to gain greater revenue through capital investments abroad. To accomplish this, companies often need to accept certain risks that such foreign activities can pose as the cost of doing business.

In particular, as companies make significant capital investments in foreign countries, they accept unavoidable political risks to the ongoing stability—or the occurrence of instability—in those countries. The political risks in a given country are usually inversely proportional to the strength of government institutions and the rule of law. Thus, in countries where government institutions and the rule of law are weak, the political risks are highest. These risks can manifest themselves in, for example, the nationalization of a company's manufacturing facilities; the reneging by a foreign host country on agreements for access to necessary utilities, suvch as water rights; the damage or destruction of a company's facilities in the course of civil unrest; and the imposition of local laws or regulations which undermine foreign investments in favor of domestic operations.

And yet companies are not bereft of options to recover lost foreign investments when such political risks turn into reality. When foreign investments go south, companies may have the ability to seek relief under bilateral investment treaties (BITs). BITs are international agreements between two countries that establish terms and conditions for businesses to invest their capital in each country, and typically offer companies a number of guaranteed protections, including fair and equitable treatment, most-favored nation or national treatment clauses, redress for expropriation, and security under the law. In addition—and most importantly—BITs ordinarily allow for violations to be redressed in international arbitration, as opposed to having to sue a host country in its own courts.

Fair and Equitable Treatment

The "fair and equitable treatment" standard is the basic standard that a host country must provide to companies under most BITs. Typically, the analysis of whether treatment of a company's foreign investment is fair and equitable follows two prongs: First, government action in a host country must be found unreasonable and arbitrary to be prohibited. Second, the standard requires that a host country behave consistently with the legitimate expectations of the company. While illegal government conduct in a host country may not be per se disallowed under this standard, governments in host countries are usually required to maintain the legal and business environment at the time a given foreign investment is made.

For example, in 2009 a $165 million award to a U.S.-based water services company was upheld in its dispute with the government of Argentina regarding the company's acquisition of an exclusive right to operate a water and sewage utility in Buenos Aires. When concerns about water quality were raised soon after the U.S. company commenced operations, an Argentine water regulator ordered that the company cease charging its customers for several weeks and pay a fine. The company denied liability, claiming that the water-quality conditions pre-dated its acquisition and were the result of improper construction and maintenance of water treatment facilities by provincial government authorities. Ultimately, the company commenced arbitration proceedings and alleged, among other claims, that Argentina failed to provide it fair and equitable treatment.

Most-Favored Nation and National Treatment Clauses

Related to the fair and equitable treatment standard, many BITs also incorporate either a most-favored nation clause or a national treatment clause. Each is aimed at leveling the playing field for companies making capital investments in a foreign host country. Under most-favored nation clauses, companies making foreign investments are assured treatment that is at least equal to that of other foreign investors in the host country; under national treatment clauses, foreign investors are assured treatment that is at least equal to that of a host country's own citizens.

The interpretation of these clauses is not without controversy, however. Foreign investors, for example, have asserted in some circumstances that a most-favored nation clause in one of a host country's BITs allows an investor to avail itself of dispute resolution processes allowed for in the host country's other BITs.

The issue came up in a 2005 case involving a Cypriot company that had acquired shares of a privatized Bulgarian oil refinery. The company had hoped to rehabilitate the refinery, but the operation soon fell into bankruptcy and liquidation. Afterward, the company asserted claims against the government of Bulgaria related to environmental liability, privatization, and other issues. In arbitration, the company sought to rely on dispute settlement provisions in a third-party treaty, based on the most-favored nation clause of the BIT between Cyprus and Bulgaria. The arbitration tribunal, however, rejected that approach, ultimately holding that an intent to extend a most-favored nation clause to protections provided under other treaties must be clear and unambiguous in order for them to apply.

Redress For Expropriation

When a company's assets or capital investments in a foreign host country are expropriated, BITs typically provide a forum for redress. Indeed, most BITs obligate host countries to compensate foreign investors when such expropriation occurs. Typically, compensable expropriation takes two forms under BITs: direct and indirect.

Direct expropriation happens when a company's assets in a foreign host country are taken, physically or legally. Indirect expropriation—in the broadest sense—may occur when government conduct by a foreign host country deprives a company of rights, control, or value of an asset, even though the company may legally retain title. Understanding the conditions in which expropriation—direct or indirect—is actionable under a particular BIT is thus very important to understanding the protection a BIT provides to foreign investments in a given host country.

Security Under the Law

In addition to providing protections against discriminatory business practices for companies making foreign investments, BITs also commonly require host countries to protect such foreign investors and their assets. This is generally understood to mean that a host country will preserve the physical integrity of foreign investors—as well as their capital investments—and shield them from adverse actions by military, local police, or other security forces operating in the country, as well as from damages caused by civilians or nongovernmental agents during periods of unrest or rebellion.

Availability of International Arbitration

While the protections outlined above are key parts of most BITs, it is crucial for companies investing in foreign host countries to understand in what forum any grievances under a BIT must be redressed. In particular, it often is in a company's best interest to ascertain the availability of international arbitration as a forum for complaints involving the breach of a BIT by a host country, as opposed to seeking compensation in that country's local courts.

Enforcement through international arbitration is one of the common features of most recent BITs. BITs frequently provide companies that make foreign investments with the choice of where to litigate their claims, and typically do not require investors to first exhaust local legal or administrative remedies before resorting to an international arbitration forum.

Knowing the terms and conditions of a BIT's arbitration clause before making capital investments in a host country, however, is imperative, particularly since it may include unique limitations that are not universally accepted. For example, some BITs contemplate a "cooling off" period of anywhere from three to six months before commencing arbitration; other BITs require claims to first be filed in some form or to be litigated for some period of time in a host country's local courts prior to a foreign investor commencing international arbitration.

However, once a decision is made to pursue international arbitration—and the requisite conditions are met under the terms of a BIT—foreign investors are usually provided with several alternative arbitration forums to choose from. These forums may include an arbitration under the International Centre for Settlement of Investment Disputes (ICSID) Convention; an ad hoc arbitration under the rules of the United Nations Commission on International Trade Law (UNCITRAL), or the International Court of Arbitration through the International Chamber of Commerce. Before pursuing an international arbitration involving a BIT, therefore, it is in a company's best interest to weigh the advantages and disadvantages of one arbitration forum over another to ascertain the most favorable setting given the unique facts of a particular dispute.

Conclusion

BITs provide pathways for companies to recover investment losses in foreign countries when the playing field has shifted in a discriminatory way, business conditions have changed due to political events, or assets have been taken through government conduct either directly or indirectly. Thus, as companies continue making capital investments in foreign countries, knowing whether a BIT is in place—and the specific terms and conditions that apply—can be vital to protecting those assets while providing a forum to remediate lost investments should the need arise.

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