# A two-way street

## A guide to the use of bilateral investment treaties

*By Michael Nolan and Teddy Baldwin*

Since the mid-1990s, India has moved rapidly to sign bilateral investment treaties (BITs) with various countries. It signed its first BIT with the UK in 1994 and went on to reach agreements with the Netherlands, France, Germany and the Russian Federation. It now has at least 66 BITs, including with countries such as Ghana, Yemen and Sudan, although it has yet to conclude an agreement with its largest trading partner – the US – or with China.

The issue of BITs has risen to prominence recently as a result of claims against India from foreign investors in the telecom sector. Several of these claims, individually, could result in damages of billions of US dollars.

Sistema, a Russian company, announced in April that it would bring international claims against India to recoup the US$3.1 billion it had invested in India's telecom sector. Days later, Telenor, a Norwegian company, announced that it would seek US$14 billion in damages from India over the cancellation of 22 2G licences by the government.

On 17 April, a Dutch subsidiary of Vodafone served a notice of dispute on India over proposed amendments to the country's tax legislation that would force the company to pay US$2.6 billion in taxes. And earlier this month, The Children's Investment Fund (TCI), a UK hedge fund, moved against India over its pricing policies for Coal India. (For more on TCI's allegations against Coal India, see page 33).

In the past, such claims have been rare. One of the best-known cases was a dispute over India's Dabhol Power project in the early 2000s, which led to at least two BIT claims by the project companies and seven such claims by the project lenders, according to a 2005 UNCTAD report. These claims have since been settled.

Statistics from the International Centre for Settlement of Investment Disputes (ICSID), an arm of the World Bank that administers a portion of these investor-state disputes, shows a large increase in the cases being brought forward. From 1972 to 1995, ICSID registered

only 38 investor-state disputes. Last year alone, ICSID registered the same number of such cases. Many investor-state disputes are brought through ad hoc arbitration, so the number is even higher than statistics indicate.

## Common BIT provisions

India's bilateral treaty provisions are to some extent standardized. Many BITs allow claimants that are nationals of countries that have treaties with India to bring claims against the government based on expropriation without prompt, adequate and effective compensation; unfair and inequitable treatment; or denial of justice by Indian courts. Most BITs also contain most-favoured nation (MFN) clauses, which permit an investor to claim more favourable substantive protection under other treaties that India has signed.

For example, the India-Netherlands BIT contains all of the protections stated above, including an MFN clause, as well as a clause requiring India to observe its obligations with investors.

Indian lawyers have been focusing on claims that have been brought or threatened against India. One lawyer predicts that India will soon be stormed by claims from its treaty partners, and other lawyers also foresee that international disputes targeting India will rise.

However, with inbound investment has come aggressive outbound investment by Indian companies extending their global reach. India is increasing its exports rapidly, with a growth rate of almost 60% in 2011. As these exports and investments continue to increase, Indian investors could themselves become claimants in international arbitration. Thus, Indian investors will benefit from the same protection abroad currently being employed by foreign investors in India.

## How BIT claims work

The key to understanding a BIT claim is that the claim belongs to the foreign investor – not to the local company. The investor's claims are separate and above any contract or domestic claim that the local company may have against the state where the investment is made (the host state). Furthermore, even the resolution of a dispute between the host state and the domestic company will not necessarily extinguish the claim of a foreign investor.

The definition of what constitutes an investment is quite broad. The India-Netherlands BIT defines an "investment" as "every kind of asset invested in accordance with national laws" including, for example, mortgages or liens, rights under a contract and rights derived from shares of a company.

For example, Sistema and Telenor will claim as an investment their shares in the Indian companies with which they have partnered – in this case, the Shyam group and Unitech Wireless. Sistema and Telenor can be expected to assert that the government's action diminished the value of their shares, making them worthless. They may also claim to have an indirect investment in the licences themselves.

The claims of Sistema and Telenor under the treaties are separate from any claims that Shyam and Unitech Wireless may make against the Indian government.

## Expropriation

A dramatic type of investor-state dispute occurs when a government uses its armed or police forces to storm an investor's property and forcibly expropriates its assets. Today, governments rarely expropriate an investment by force, but rather do so through the courts or legislature.

An example of this is Argentina's recent move to expropriate oil company Yacimientos Petroliferos Fiscalas (YPF). Last month, Argentina's president, Cristina Fernandez de Kirchner, declared that Argentina would take a majority share in YPF from Spanish oil and gas company Repsol and proceeded to replace YPF's management. On 7 May, Argentina's Chamber of Deputies approved the expropriation of YPF, with 207 votes in favour and 33 against.

Argentina has stated that it will pay Repsol for the expropriated shares, but it is widely expected that any compensation will fall far short of the market value of YPF's shares prior to the expropriation. Thus, even if Repsol receives compensation from Argentina, Repsol will likely still have its international claims against Argentina for the difference between the amount paid by Argentina and the value of the company.

## Revocation of licence or concession

Another well-known type of investment claim results from the revocation of a licence or concession based on a purported application of domestic law. The success of a claimant in this circumstance depends in large part on the actions of the state during the course of the investment, as well as the actions of the state after the licence or concession has been revoked. These disputes often become a battle about the allegedly bad behaviour of the investor versus that of the state. The case of *Genin v Estonia* illustrates this point.

In Genin, US investors brought a case against Estonia following the revocation of a banking licence. Both sides accused the other of wrongdoing and bad faith. Genin claimed that Estonia gave no advanced notice of a possible revocation and that Estonia made unreasonable demands of the investors. Estonia claimed that Genin failed to provide information about its investment despite repeated requests to do so.

The ICSID tribunal noted that Estonia had only recently become independent when the investors initially invested. The tribunal found that Estonia was justified in revoking the licence even though it was critical of Estonia's behaviour. The tribunal voiced its hope that "Bank of Estonia will exercise its regulatory and supervisory functions with greater caution regarding procedure in the future."

## Unusual cases

The examples above show what investment arbitrations are often about. The following are some examples of cases where BITs have been used in more unusual, and perhaps more surprising, situations. The types of cases below do not always succeed and their success often depends on the specific facts at issue. But states and investors alike should be aware that behaviour that seems to be the prerogative of a state might nevertheless result in an order for the state to pay the investor's damages. Even when the government acts under the cloak of necessity, tribunals have looked underneath that cloak and found governments liable for BIT violations.

## Claims against municipal government actions

The central government of a country may find itself defending a claim by an investor even if the government was not involved in the dispute, and even if it fully supported the investor's efforts. BITs typically protect against acts by government officials at all levels. In *Metalclad v Mexico*, Metalclad obtained permits to construct and operate a landfill. The Mexican federal government fully supported the project and issued permits and other approvals. Mexican state officials were likewise initially supportive of the project and issued approvals.

After Metalclad began operating, the municipal government denied a permit to operate the landfill. The ICSID Metalclad tribunal found that the municipal government was wrong to deny the permit and imputed this wrongful behaviour to the Mexican federal government under the doctrine of state responsibility. This occurred in the absence of any allegations by Metalclad that Mexico was responsible for the denial. Ultimately, Mexico – not the municipal government – was ordered to pay Metalclad approximately US$17 million.

## Slow court proceedings

A state could be found to have violated its treaty obligations for having a slow judiciary. An Australian mining company, White Industries, obtained an award against India last year for delays in the Indian judicial system. White Industries had obtained an international commercial arbitration award against state-owned Coal India in 2002, and had been engaged in court proceedings to enforce the award in India for several years without being able to have the award enforced.

White Industries waited for five years for the Indian Supreme Court to hear its case. The ICSID tribunal found that this delay deprived the company of an "effective means" of asserting its claims and enforcing its rights. Similarly, delays in the court system that deprive an investor of the opportunity to have its case heard could result in a violation of that state's international treaty obligations.

## Claims against your own state

Some investors have been able to use the corporate veil to bring claims against their own state. In the seminal case of *Victor Pey Casado v Chile*, Pey Casado transferred 90% of his shares in an expropriated entity as a gift to a foundation he created. The foundation was not a Chilean entity and was therefore able to bring claims against Chile.

The ICSID Pey Casado tribunal refused to look behind the corporate veil to the beneficial ownership of the foundation. It likely considered that the foundation had been in existence before the claim arose and was not, therefore, an entity created solely for the purpose of obtaining BIT protection.

Consequently, according to the tribunal, nationals could technically create an entity of another nationality and then bring suit against the nationals' home state through use of a corporate entity.

## Denying licence applications

Among the many cases where an investor challenges the revocation of a licence, a US investor prevailed on a claim that repeated denials of his licence applications in Ukraine violated the bilateral investment treaty. In *Lemire v Ukraine*, the investor claimed that Ukraine had only granted it one licence despite its 200 applications, while politically connected businesses had received dozens of licences.

A majority of the tribunal agreed and found that Ukraine had violated the fair and equitable treatment protection in the BIT by not providing an equal playing field for licence concessions. This decision provides some hope for investors that are discriminated against in favour of local companies for lucrative licences and concessions.

## Discrimination without intent

Another frequent claim by investors is for discrimination. Sometimes this claim is based on a fact or incident which shows that the legislature or government officials sought to discriminate against a particular country or foreign investors in general. But such a display of discrimination may not be required. Discrimination can be found if the effect of a law falls disproportionately on foreign investors, or even if the government discriminates against certain sectors of the economy.

The ICSID tribunal in *Occidental v Ecuador* made such a finding. In Occidental, Ecuadorian tax authorities reversed an earlier interpretation of the country's tax laws and consequently refused to grant 10% value-added tax refunds for oil exporters. This reversal only applied to oil exporters and not to other exporters of goods.

**Potential protection:** With outbound investments on the rise, Indian companies could themselves become claimants in international arbitration.

Ecuador argued that the reversal on the tax determination was not discriminatory because it applied to all companies that exported oil, not just foreign investors. The tribunal rejected Ecuador's argument, concluding that a party need not demonstrate discriminatory intent by the state to prevail on a discrimination claim so long as the investor is treated differently from domestic companies in other sectors. The tribunal viewed the comparative group as exporters at large rather than just oil exporters.

## Release of sensitive information

Governments are often a repository of sensitive information. From tax returns to trade secrets, governments collect and maintain information about businesses operating in their country. Investors have been able to prevail on claims against host states for the release of sensitive information where the release caused harm to the investor.

In *Saluka Investments v Czech Republic*, the bank in which the investor had shares, Investièní a Poštovní banka (IPB), sent a proposal to the Czech central bank in an effort to stabilize IPB.

The proposal noted that IPB would be insolvent if the Czech central bank did not act quickly. A month later, central bank officials were quoted in a newspaper as saying that IPB was in danger of being closed and that a forced administration was possible. A central bank official was further quoted as saying that IPB did not have adequate reserves and that the government might withdraw IPB's licence.

After this information was made public, there was a run on IPB that resulted in the bank being forced to close and, ultimately, led to its insolvency. Even though the tribunal found that all the information released by the Czech officials was accurate, it held that the release of this sensitive information "impaired" Saluka's investment. The tribunal ordered the Czech government to compensate Saluka for the damages caused by the disclosure of this sensitive information.

## Conclusion

The next few years will be an interesting time for India as it deals with substantial international arbitration claims. Any of the claims described above could be made against India. Indian businesses could also take advantage of India's extensive BIT network to bring such claims as investors. (For more on bilateral investment treaties, see our correspondents' views on page 49.) ■

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