

The use of bilateral investment treaties in oil & gas



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London-based Steptoe & Johnson Partners **Matthew Coleman** and **Gavin Coull** point out what insureds and insurers in the oil & gas market should know about bilateral investment treaties to protect their interests.



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In recent years, there has been an increase in measures taken by host states against the oil & gas investments of foreign investors. These measures have ranged from outright expropriation of the investment to a unilateral change in the royalty and tax regime, which may seriously undermine the economic basis on which the investment was made. In many such cases, the investor's losses (and therefore ultimately the insurer's) are in effect not recoverable because the investor is limited to bringing an action in the domestic courts of the host state or instituting a domestic arbitration where a fair hearing against the government of the host state is not possible.

However, there is an easy solution to this problem, which is to ensure that the investment is structured in such a manner so as to ensure that there is a bilateral investment treaty (BIT) in place (containing a dispute resolution clause) between the investor's home state and the host state into which the investment is made. Given the proliferation of BITs between states, it continues to remain a mystery as to why more investors do not ensure, and insurers do not insist, that where possible the investment is structured in a manner so that the investment is covered by a BIT.

This article considers the basics of bilateral investment treaties and explains how investors (and insurers as a condition of coverage) can structure the investment so as to ensure that it is protected by a BIT.

An overview of BITs

BITs are treaties or agreements between states which provide that nationals (corporates or individuals) of each state, when investing in another state, will together with their investments, be accorded certain rights and protections. BITs only bind states once they have been ratified.

The most common protections under BITs are fair and equitable treatment, full security and protection, treatment at least as good as that provided by the host state to its own nationals (national treatment) or to nationals of third states (most favoured nation), repatriation of investments and returns, and no expropriation unless against prompt, adequate and effective compensation.

Importantly, in the event of a dispute between the host state and the investor, BITs invariably provide for a standing offer by the host state to submit the dispute to binding

international arbitration, which may be commenced by the investor. A breach of a BIT entitles the investor to damages to a level that would wipe away the consequences of the wrong.

BITs are unique in that they are international agreements between states that give enforceable rights to corporates and individuals. Furthermore, BITs will provide protection to covered investors, whether or not the investor has a contractual relationship with the host state.

There must be an "investor"

In order to be an "investor" covered by a BIT, the investor needs to be a national of one of the contracting states to the BIT on which it seeks to rely. A company will be a national of many of the model BITs drafted by states if it is incorporated in the state of which it asserts nationality.

Treaty shopping

In many instances, there may not be a ratified BIT between the home state of the investor and the host state into which it wishes to make or has made the investment. However, this problem can be easily solved in many instances.

Take for example the situation where a Canadian investor wishes to invest in Jordan. There is no ratified BIT between Canada and Jordan. However, there is a ratified BIT between Jordan and the UK. In order to obtain the protection of the BIT between Jordan and the UK, the Canadian investor need only incorporate a company in the UK and ensure that the UK company owns the investment in Jordan. Such a structure will entitle the UK company to bring a claim under the BIT in the event that a measure is taken by the Jordanian Government which damages the investment.

However, a word of warning: consider the tax position that may be created by adding the newly incorporated company to the structure.

Furthermore, it is essential that any structuring of this kind is done before the dispute arises, otherwise such arrangements are likely to be characterised as "forum shopping", which is not permitted.

There must be an "investment"

Furthermore, a BIT only applies to "investments" made by foreign investors into the host state. The term "investment" is defined very widely in most BITs to cover "every kind of

asset”, including shares, debt instruments, land and moveable property. Very wide interpretations have been given to these definitions by arbitration tribunals. However, a one-off sale agreement will not be deemed to be an “investment”.

Protections offered to investors under BITs **Access to international arbitration**

Most BITs provide that a foreign investor may refer disputes between it and the host state arising out of an investment to international arbitration. This right is a fundamental right because without it all of the other rights cannot be enforced by the investor. The vast majority of BITs provide for arbitration at the International Centre for the Settlement of Investment Disputes (ICSID), a World Bank arbitration forum. However, some BITs also have provision for other arbitration forums and ad hoc arbitration.

Many BITs expressly take account of rights of subrogation. In any event, it is permissible for insurers to bring a claim in the name of the insured under a BIT, and indeed this firm has acted in such circumstances.

Monetary arbitration awards rendered by tribunals constituted pursuant to the ICSID Convention are enforceable in each of the 144 states that have ratified the ICSID Convention as if they were a final judgment of a court of the state in which they are to be enforced – there are no grounds for refusing to enforce the award for public policy reasons or otherwise. If the arbitration tribunal under the BIT was constituted other than under the ICSID Convention, then enforcement will be through the New York Convention. In any event, enforcement will be subject to the laws of sovereign immunity.

Fair and equitable treatment

Fair and equitable treatment is a very wide protection. It is impossible to give an exhaustive definition of the fair and equitable treatment standard. However, essentially under the standard, the investor must be treated in a consistent manner, free from ambiguity, transparently and in accordance with the investor’s legitimate expectations. The most common situation in which states are found to have breached the fair and equitable treatment standard is where a particular regulatory regime is promised to the investor (eg, relating to royalties and taxes) but is then unilaterally changed.

Full protection and security

The right to full protection and security places an obligation on the host state to act diligently so that the investor’s investments are not damaged.

National treatment

National treatment is the right to be treated at least as favourably as nationals of the host state. This limits the state’s ability to favour its “national champions”.

Most favoured nation

Most favoured nation treatment (MFN) is the right of a foreign investor to be treated at least as favourably as the nationals of a third state. MFN clauses are a way of ensuring that the host state does not have distorting investment policies through different standards with different investors of various nationalities.

Repatriation of investments and returns

Repatriation of investment and returns is the right of the investor to transfer out of the host state without delay the investment and any return on the investment (such as dividends) in the currency of the original investment at the rate of exchange applicable on the date of transfer.

Expropriation or measures having effect equivalent to expropriation

BITs usually contain a right stating that the foreign investor’s investment will not be subject to expropriation or measures having effect equivalent to expropriation unless it is for a public purpose, on a non-discriminatory basis and against “prompt, adequate and effective compensation”. In this context, “prompt” means soon after the expropriation; “adequate” refers to the quantity of compensation and is generally regarded as meaning the full market value of the property taken; and “effective” means compensation paid in a convertible currency, usually the currency in which the investment was made.

Summary

It is trite to state that the world is becoming more globalised. However, as it does, many investors and their insurers are simply adopting the same due diligence and appraisal processes that they undertake in more established markets. This, in many cases, has led to a failure to utilise the protections available through BITs. However, if the investor’s dispute with the host state has not yet arisen, then it is not too late to treaty shop in order to obtain protection under a BIT. ■

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