

Relying on treaties to protect investments in Eastern Europe

Mark Gitenstein

Special Counsel

Washington DC

mgitenstein@mayerbrown.com

Dany Khayat

Partner

Paris

dkhayat@mayerbrown.com

Jeffrey W. Sarles

Partner

Chicago

jsarles@mayerbrown.com

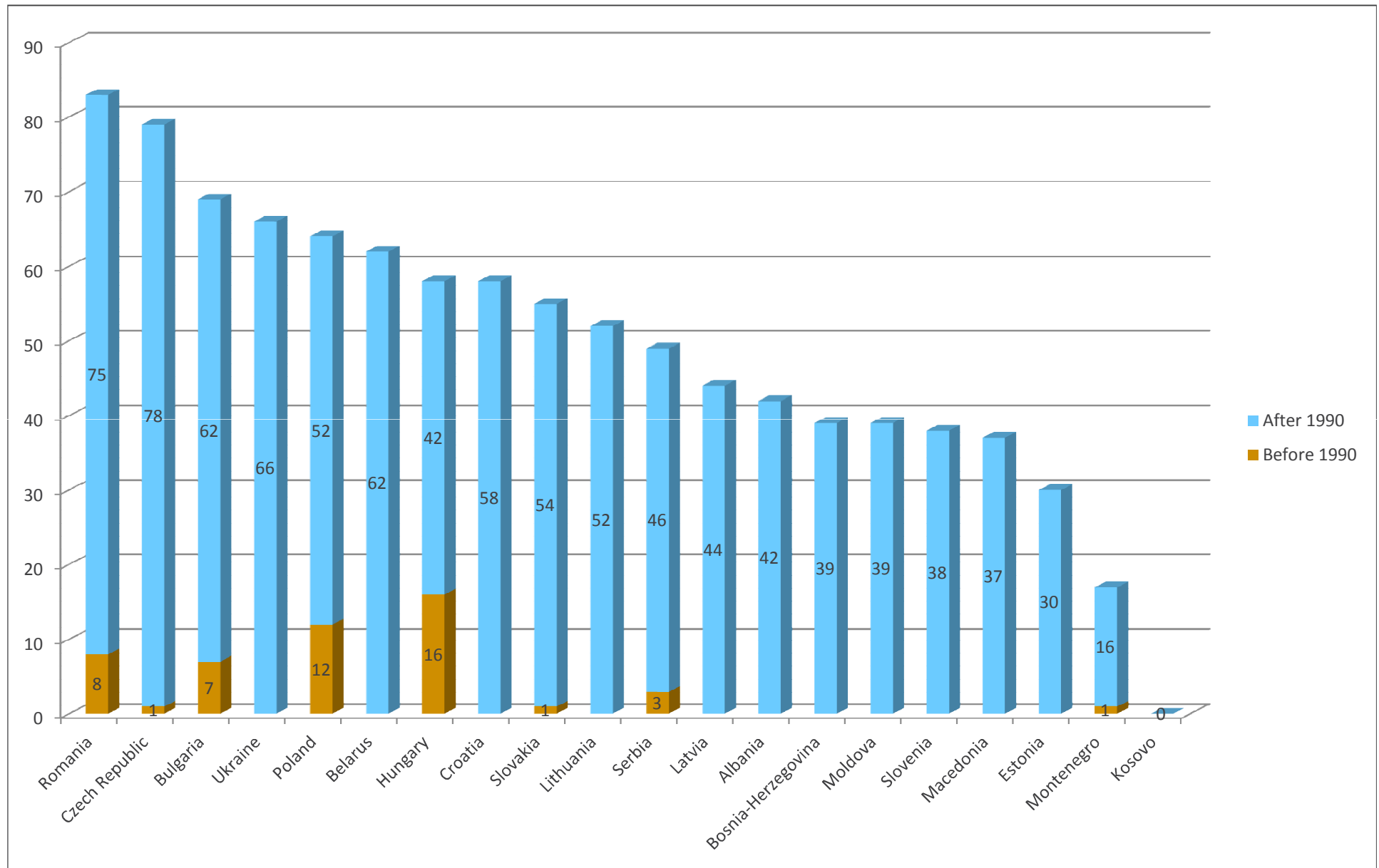
Hypothetical Foreign Investor Scenarios

- Company A was invited by Hungary to supply electricity to residents under a prescribed rate formula. Due to protests and pressure by social groups, the Hungarian authorities changed the rate formula, causing Company A's revenues to plummet and forcing it to cease its operations.
- Company B has been supplying Romania's schools with textbooks since it entered into an exclusive contract for that purpose when Romania deregulated. After administrative harassment by regulatory bodies, the Romanian authorities canceled Company B's license for failure to comply with a formality and conferred the license on a politically connected domestic company.
- Company C invested in Bulgaria largely because of tax credits offered for mineral exploration investment. Several years later, after Company C had incurred the bulk of its investment costs, the Bulgarian government changed and the new administration repealed the tax credits.

Navigating the World of Investment Treaties in Eastern Europe

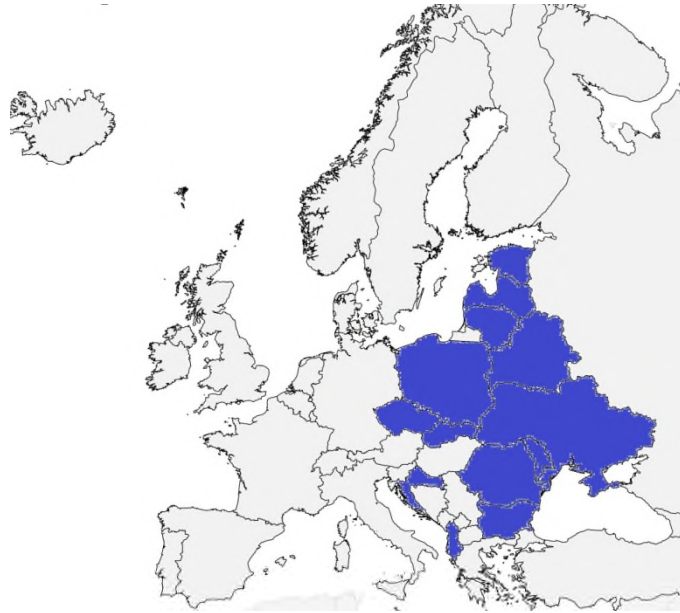
- Investment treaties are international agreements between two States (bilateral treaties) or several States (multilateral treaties)
- They contain undertakings and obligations by the States that can be directly invoked by foreign investors.
- There are thousands of bilateral investment treaties signed in the world. Unlike trade treaties, investment treaties are a recent phenomena that developed in the 1980s
- Several multilateral treaties also contain provisions on investment.
- Eastern European States have followed suit and have signed many investment treaties

Bilateral Investment Treaties in Eastern

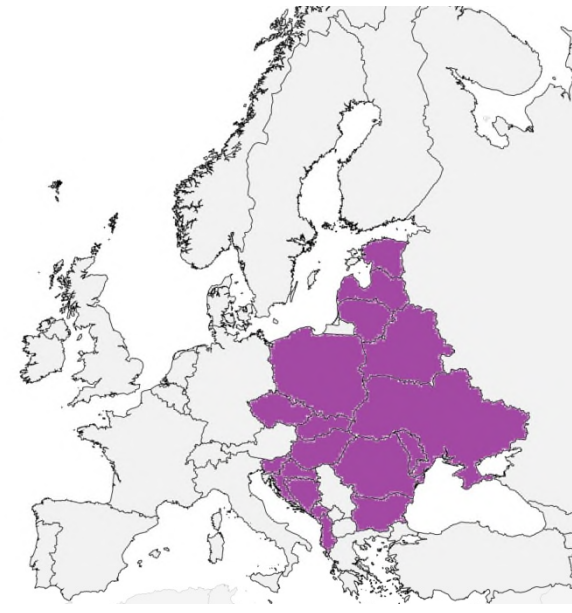


As at June 2013 - Source: UNCTAD's Investment Instruments online database

Bilateral Investment Treaties in Eastern Europe



United States' BITs with Eastern European States

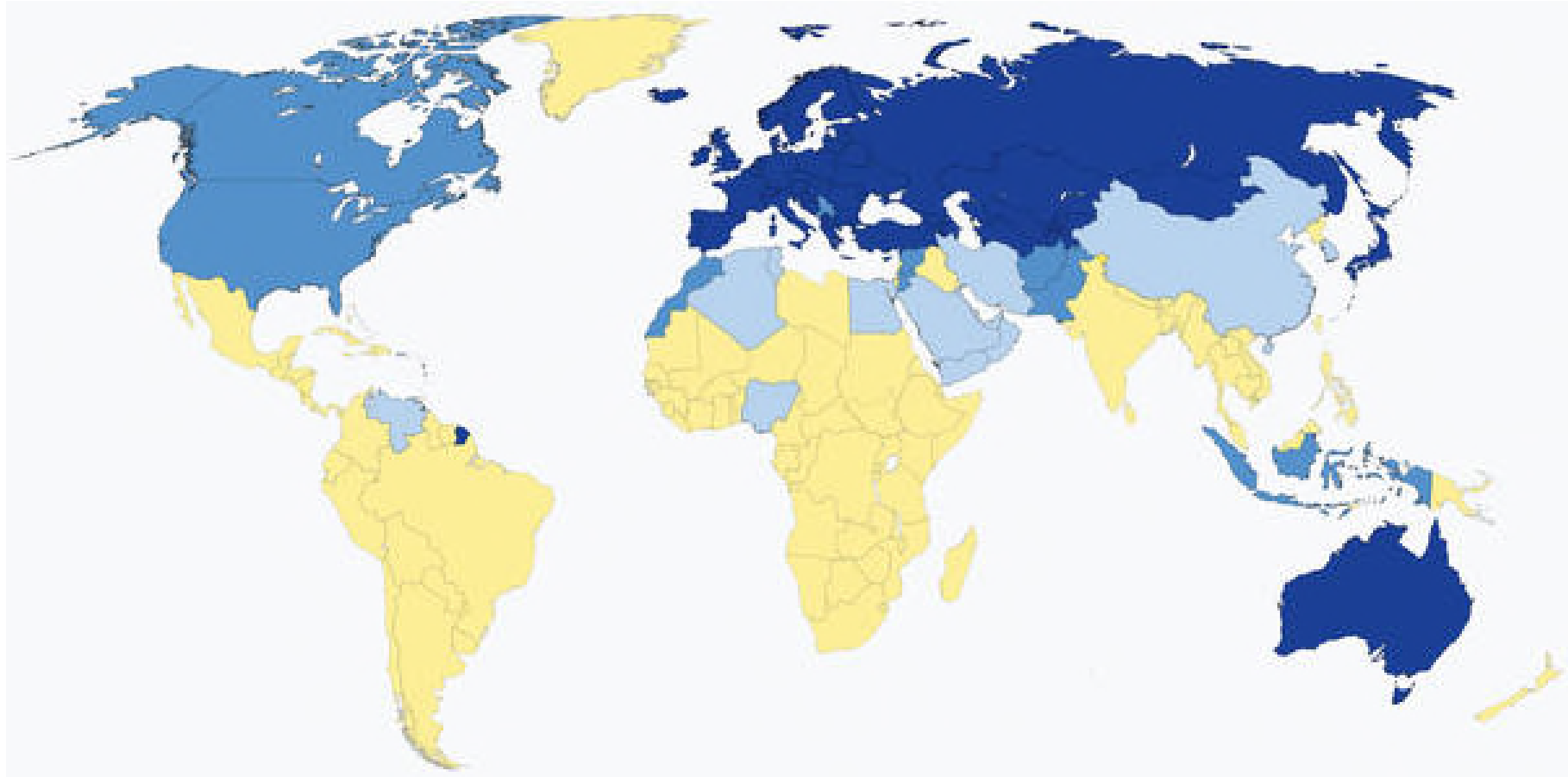


United Kingdom's BITs with Eastern European States



The Netherlands' BITs with Eastern European States

Energy Charter Treaty Members



- Dark blue designates signatories to the 1994 Energy Charter Treaty, and members of the Energy Charter Conference
- Blue designates signatories to the 1991 Energy Charter, and observers to the Energy Charter Conference
- Light blue designates observers to the Energy Charter Conference by invitation of the Conference

As at October 2013 - Source: Energy Charter Treaty Secretariat

Who and What do Investment Treaties Protect?

- Investment treaties apply to foreign – not domestic – investors.
- An “investor” is either an individual citizen of a treaty country or a company incorporated or constituted under that country’s laws.
- Investment treaties generally define “investment” broadly to comprise all manner of tangible and intangible assets and rights.
- Prospective investors should review the specific provisions of applicable treaties carefully to ensure maximum protection.

Common Investment Treaty Provisions

- **Expropriation**

- Investment treaties do not forbid expropriations (if they are for a public purpose and nondiscriminatory).
- Rather, they require the host State to compensate foreign investors promptly, adequately, and effectively for any expropriation.
- Most BITs require compensation for “indirect” expropriations and measures that are “tantamount” to expropriation.

Common Investment Treaty Provisions (cont'd)

- **National Treatment and Most Favored Nation**
 - A State discriminates based on nationality if it treats foreign investors less favorably than similarly situated domestic investors.
 - A State that favors one or more foreign investors more favorably than other similarly situated foreign investors violates the most favored nation guarantee.

Common Investment Treaty Provisions (cont'd)

- **Fair and Equitable Treatment**

- A rough consensus has developed over the factors relevant to this flexible principle.
 - Did the State action upset an investor's legitimate expectations or was it otherwise arbitrary?
 - Did the State offer a stable and predictable legal framework?
 - Did the State make specific representations to the investor?
 - Was the investor denied due process?
 - Was the State's legal procedure or conduct transparent?
 - Did the State engage in harassment, coercion, abuse of power, or other bad faith?

Common Investment Treaty Provisions (cont'd)

- **Freedom of Transfer**

- The host state must permit all transfers of money and related assets freely and without delay into and out of its territory.
- This protects against currency control regulations or other State acts that effectively freeze investor funds.

Application to Investor Scenarios

- Does Company A, whose electricity supply business was pummeled by the State's change in the rate formula, have an expropriation or unfair/inequitable conduct claim?
 - Did the change simply lower the investor's profits or truly force it to abandon its investment?
 - What did the authorities tell the investor about rate changes prior to the investment?
 - Was the formula change historically unusual or otherwise not reasonably foreseeable?
 - Was the process that led to the change transparent?
 - Did the investor meet its own supply and service obligations?

Application to Investor Scenarios (cont'd)

- Does Company B, which lost its exclusive license to supply school textbooks, have a treaty claim?
 - The same type of analysis would apply, with special emphasis on the Company's noncompliance with the formality.
 - How has the government treated similar violations by other foreign investors? By other domestic investors?
 - Did the authorities provide sufficient notice to the investor?
 - Did the authorities give the investor a fair opportunity to correct its mistake?
 - Was this a setup to allow political favorites to grab the benefits of the investment?

Application to Investor Scenarios (cont'd)

- Does Company C, which lost its tax credits after it made its investment, have a treaty claim?
 - Many treaties limit tax measure challenges to expropriation and transfer claims.
 - Thus, investors may not be able to claim unfair, inequitable, or discriminatory treatment.
 - It is difficult to prove expropriation unless the entire investment has been lost.
 - In some cases, tax treaties may provide potential relief.

Energy Charter Treaty

- The ECT sought to ensure open energy markets after the dissolution of the Soviet bloc. Over 50 countries plus the EU are signatories.
- The ECT applies to investments associated with virtually any “economic activity in the energy sector.”
- The ECT applies to state enterprises as well as the government itself.
- The ECT seeks to ensure non-discrimination; promote free transit of energy products, investment capital, and returns; prevent anticompetitive conduct; and provide neutral and fair dispute resolution.

Arbitration Provisions Make Investment Treaties Effective

- Before the advent of modern investment treaties, investors lacked viable options to resolve disputes with host States.
- Today, investment treaties provide a neutral, fair, and expert means of resolving investor-state disputes.
- The investor may choose to submit the dispute to the host State's courts or administrative tribunals or to arbitration under:
 - the ICSID Convention or Additional Facility Rules;
 - the UNCITRAL or (in some cases) the Stockholm rules; or
 - any other rules to which the parties agree.

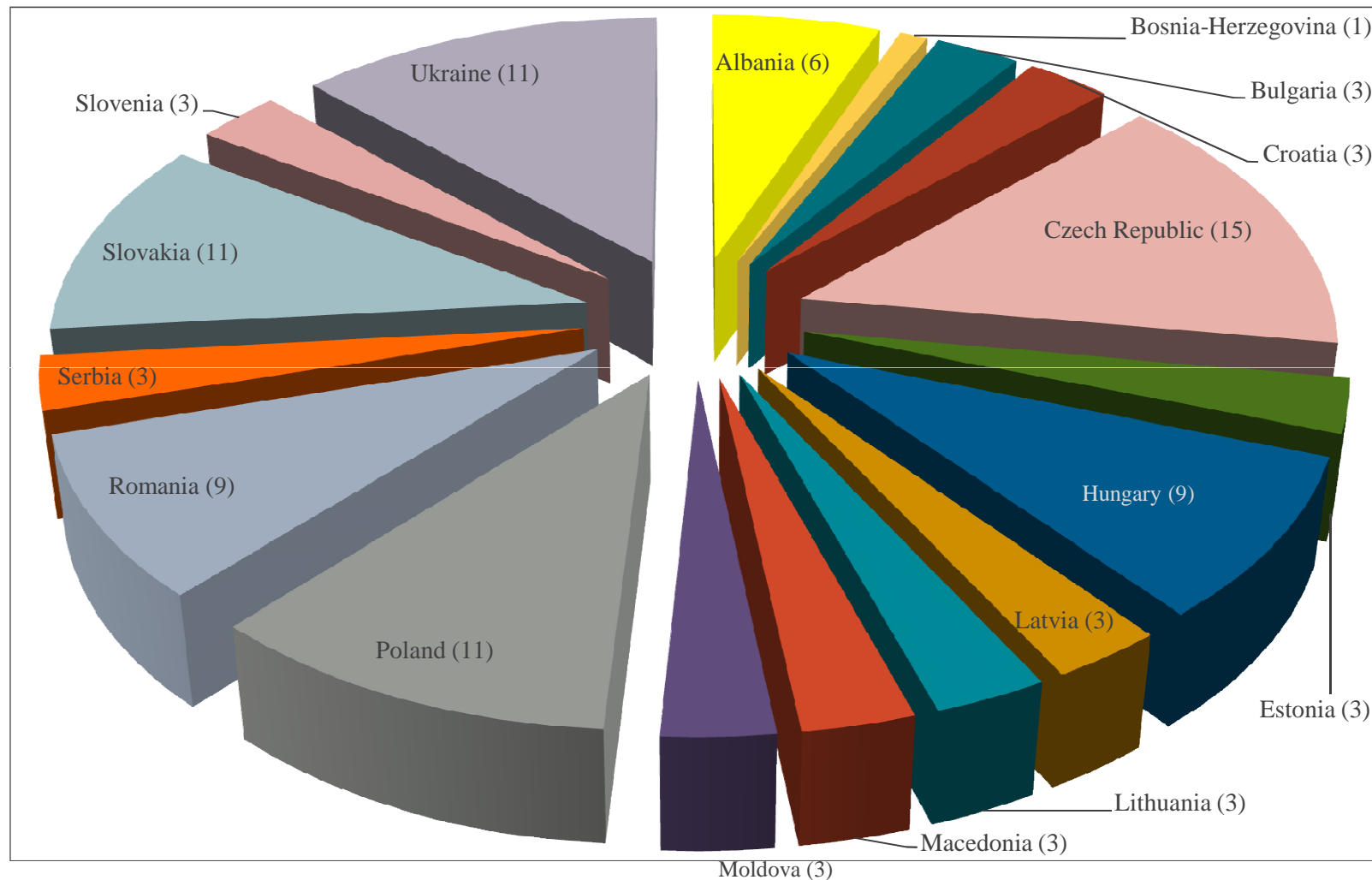
Arbitration Provisions Make Investment Treaties Effective (cont'd)

- Generally the parties jointly select an arbitral panel.
- The panel receives documentary evidence and witness testimony and applies the applicable law to the investor's claims and the State's defenses in a written award.
- ICSID awards are not subject to appeal or review by national courts. Monetary awards must be recognized and enforced as if they are final judgments of domestic courts.
- ICSID arbitration tends to be more public and transparent than UNCITRAL arbitration.

Investment Arbitration Cases in Eastern Europe

- Arbitration by foreign investors against the host State of the investment pursuant to investment treaties is common practice
- Eastern European States have had their share of treaty arbitrations in the past ten years in a variety of sectors and with mixed results

Investment Arbitration Cases in Eastern Europe



As at June 2013 - Source: Websites of ICSID and Investment Treaty Arbitration websites

Pending Investment Arbitration Cases in Eastern Europe

Country	Case	Subject Matter
Albania	Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A. v. Republic of Albania CEZ v. The Republic of Albania	Oil storage and distribution project Power distribution company
Bulgaria	Novera AD, Novera Properties B.V. and Novera Properties N.V. v. Republic of Bulgaria EVN AG v. Republic of Bulgaria	Waste management services Electricity supply and distribution operations
Czech Republic	<u>Antaris Solar GmbH and others v. Czech Republic</u>	Solar energy enterprise
Croatia	Georg Gavrilovic and Gavrilovic d.o.o. v. Republic of Croatia Lieven J. van Riet, Chantal C. van Riet and Christopher van Riet v. Republic of Croatia	Food products enterprise Tourism facilities
Hungary	<u>Electrabel S.A. v. Hungary</u> Vigotop Limited v. Hungary Emmis International Holding B.V., Emmis Radio Operating B.V., et al. v. Hungary Accession Mezzanine Capital L.P. and et al. v. Hungary Dan Cake (Portugal) S.A. v. Hungary Edenred S.A. v. Hungary	Electricity distribution Resort development Radio broadcasting enterprise Radio broadcasting enterprise Food product enterprise Other food service activities
Latvia	UAB E energija (Lithuania) v. Republic of Latvia	Heating services enterprise
Lithuania	<u>OAQ Gazprom v. The Republic of Lithuania</u>	Gas distribution enterprise
Macedonia	Guardian Fiduciary Trust, Ltd, f/k/a Capital Conservator Savings & Loan v. Macedonia	Trust banking operations
Montenegro	MNSS B.V. and Recupero Credito Acciaio N.V. v. Montenegro	Steel production
Poland	David Minnotte and Robert Lewis v. Republic of Poland Vincent J. Ryan, Schooner Capital LLC, et al. v. Republic of Poland	Blood treatment and processing facilities Vegetable oil production enterprise
Romania	Ioan Micula, Viorel Micula and others v. Romania Hassan Awdi, Enterprise Business Consultants and Alfa El Corporation v. Romania Marco Gavazzi and Stefano Gavazzi v. Romania	Food product enterprise Press distribution Steel distribution enterprise
Serbia	UAB "ARVI" ir ko and UAB "SANITEX" v. Republic of Serbia	Fertilizer plant
Slovenia	Hrvatska Elektroprivreda d.d. v. Republic of Slovenia <u>Impresa Grassetto S. p. A.. in liquidation v. Republic of Slovenia</u>	Nuclear power plant Highway tunnel construction project
Slovakia	US Steel Corp. v. Republic of Slovakia	Steel plant

Selection of Arbitration Awards involving Eastern European States

- Favorable to investors
 - CME v. Czech Republic (2001), award of 270 million US\$ plus interest
 - ADC v. Hungary (2009), award of 83 million US\$ plus interest
- Favorable to States
 - Telenor v. Hungary (2006), lack of jurisdiction
 - Noble Ventures v. Romania (2005), rejected on the merits

Significance of Treaty Framework for Investors in Eastern Europe

- Investment treaty protection widely exists in Eastern Europe. Current and potential investors must seek to take advantage of it.
- Where applicable, investment treaty protection exists by virtue of a treaty, it does not have to be negotiated, mentioned in contracts, etc.
- Where applicable, investment treaty protection usually provides investors with additional leverage in negotiations with the authorities
- In sum, while it is not an insurance policy by any mean, it can enhance legal security and provide additional legal tools to investors facing adverse measures by host States.

Significance of Treaty Framework for Investors in Eastern Europe

- Investors must take treaty protection into account before the investment when considering the structure of the investment.
- Investment treaties are different from one another and sometimes very slight variation in the language may lead to a considerable change in protection.
- Due diligence on available treaties may provide options to foreign investors as to how to best route their investment in a given country.
- Investment treaty considerations can be coupled with an analysis of double taxation treaties.
- Considering investment treaty protection from the outset is necessary to avoid legal pitfalls after a dispute arises

Significance of Treaty Framework for Investors in Eastern Europe

- Investors must also carefully continue to consider treaty protection for the duration of the investment.
- Investment treaty protection may be lost after the investment is made in various ways.
 - Change in the structure of the investment, transfer of shares.
 - Resorting to local courts against the host State may result in preventing the reliance on the arbitration provision under certain treaties
- Once the dispute arises, as in all legal disputes, particular care must be given to any action or statements made to avoid conflicting with treaty rights.