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Avoid pitfalls in doing business with foreign firms, governments

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The problem: Projects abroad face foreign government interference. With oil and gas and other raw materials fetching record prices, it is not surprising that government interference with foreign investments in those sectors continues to rise.

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Governments also would like some share of the upside from rising prices. Bolivia recently announced nationalizations of foreigners' oil and gas interests there. Venezuela has increased its taxes, royalties and take in foreign companies' oil and gas projects.

And the risks are not just to energy companies — insurance, telecommunications, construction, banking, companies in all sectors face political perils when investing overseas. Nor are the risks new. The Arab oil nationalizations in the 1970s followed Mexico's 1938 nationalization that created Pemex.

INVESTMENT PROTECTION

Investment protection treaties offer a partial solution. The past few years have witnessed a vital sea change in favor of foreign corporate investors. Now, a large network of treaties protects investments from one country against improper actions by the governments (and under certain circumstances state-owned companies) of other countries.

The North American Free Trade Act provides one example. For example, part of NAFTA protects U.S. investors from inappropriate measures against those investors' holdings in Canada or Mexico. The U.S. government extends the same treatment to Canadian and Mexican companies and citizens.

Beyond NAFTA and similar treaties, there are over 2,300 bilateral investment treaties between most of the world's countries. All operate on the same principle: Our government will protect your investors here, and your government will do the same for our investors there.

The protection is real. Most treaties prohibit a variety of governmental abuses, including:

- Taking an investment without due process of law and without paying appropriate compensation.
- Favoring domestic companies or citizens over foreign investors.
- Failing to treat any foreign investor as well as the most-favored foreign investor.
- Treating an investment of a foreign investor unfairly.
- Failing to give foreign investments full protection and security.

INTERNATIONAL ARBITRATION

Importantly, the corporate investor can sue the government itself. But these protections are cold comfort if an investor has to sue the host state in the courts of many a host state.

Most bilateral investment treaties let the foreign investor bypass the host-state's courts and instead allow the investor to sue the host-state government in an international arbitration forum. That arbitration, which takes place outside the host-state before three impartial arbitrators, is frequently administered by an affiliate of the World Bank.

The arbitrators' awards are very difficult to challenge, and governments frequently agree to enforce the awards without endless loopholes. These procedures give investors greater comfort that the arbitration process will be impartial.

PLANNING FOR PROTECTION

Savvy investors have begun taking advantage of the treaty network to protect their assets abroad. But protection requires planning.

To qualify for bilateral investment treaty protection, a company must make an investment — referring to assets of any kind. But examples in the treaty's definition illustrate specific categories of investment.

Examples of investment in most bilateral investment treaties include rights in concession agreements to extract natural resources and equity and similar interests in companies. Thus, one common way many investors qualify for protection is by creating a subsidiary company in the host state. The company itself counts as the investment, so any harm that comes to the subsidiary company also represents harm to its owners or shareholders.

But it's not simple. For example, for a project in Gabon, a U.S. company could create a Gabonese subsidiary company. Gabon has no bilateral investment treaty with the U.S.; however it does have one

with Luxembourg. To receive protection, the U.S. company could channel its investment in Gabon through Luxembourg.

As the example shows, even though there are a large number of treaties in force, a badly planned investment may be owned by a company of the wrong nationality.

One real-world example illustrates the advantages of careful planning. U.S. investor Ronald Lauder, son of cosmetics magnate Estée Lauder through a number of companies in different countries held an interest in a Czech television station called TV Nova.

TV Nova was a successful operation, with significant market share due in no small part to a novel approach to the weathercast. Lauder claimed that measures by Czech media authorities deprived him of the benefits of his investment.

A U.S. citizen, Lauder sued the Czech government under the U.S.-Czech bilateral investment treaty. He lost his case, but one of his companies, a Dutch company, also sued under the Dutch-Czech bilateral investment treaty and won.

PLANNING NATIONALITY

Planning designed to maximize the benefits of treaty protection can help deter problems and provide valuable tools where deterrence fails. Best done when first structuring an investment abroad, it is not necessarily too late to optimize treaty protections when restructuring for other reasons, even after a potential dispute arises.

Doing so requires analyzing available options and harmonizing investment protection measures with other aspects of the transaction. And the sooner the planning is done, the greater the flexibility in choosing among options.

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