MACFARLANES

AFRICAN INSIGHTS

DEAL STRUCTURING - BILATERAL INVESTMENT TREATIES

Many of us are familiar with looking at considerations such as jurisdiction and tax when deciding upon a structure. In our latest African Insights publication we look at an area that may be less well known - Bilateral Investment Treaties (BITs).

A BIT is an agreement between two countries establishing the terms and conditions for private investment by nationals and entities of one state in another and providing a legally binding level of protection with the aim of encouraging investment flow between the two countries.

This publication looks at the key points surrounding BITs and the protections they afford.

WHAT IS A BIT?

Bilateral Investment Treaties (BITs) (also known in the UK as Investment Promotion and Protection Agreements or IPPAs) were first adopted in 1959 and there are now over 3,000 in existence across the world. The UK is party to almost 100 such treaties.

A BIT is an agreement between two countries establishing the terms and conditions for private investment by nationals and entities of one state in another. There is no registration process or fee payable in order to qualify for BIT protection. Rather, an investment simply needs to qualify for protection under the terms of a relevant BIT.

It establishes a legally binding level of protection in order to encourage investment flow between the two countries.

WHY ARE BITS IMPORTANT?

BITs are not only significant because of their potential impact in extreme cases such as expropriation and nationalisation of assets – where awards of compensation have amounted to hundreds of millions or even billions of dollars – but also offer a layer of security and reduce political risk for investments in jurisdictions or sectors which are vulnerable to government interference.

BITs are particularly useful where there are concerns about the reliability and independence of the domestic courts, as they provide for direct recourse to international arbitration giving investors greater assurance that a dispute with the host government can be dealt with fairly and swiftly.

WHAT DOES A BIT COVER?

The agreements are designed to promote and protect private investments made by nationals or entities of the signatories in each other's territory and often contain reciprocal undertakings regarding:

- non-discriminatory treatment;
- protection against nationalisation and expropriation;
- free transfer of funds;
- full protection and security;
- most-favoured-nation treatment;
- fair and equitable treatment; and
- protection to allow foreign investors to submit claims for breach of the BIT to arbitration under the International Centre for Settlement of Investment Disputes (ICSID), a tribunal which is financially supported by the World Bank, rather than local courts.

WHAT IF THE BIT IS TERMINATED BY THE HOST STATE?

The prevalence of BIT arbitration and the cost of payments pursuant to it has caused several states (most notably South Africa and Indonesia) to consider revoking their BITs.

However, most BITs state that if it is revoked, the protections provided by it will continue for eligible investors for a significant period of time, often 10-15 years.

BIT ARBITRATION

BIT arbitration will typically take two to three years or longer and approximately 450 investment treaty cases have commenced since 1959. One commentator has suggested that investors have obtained at least some compensation in 30 per cent of cases, whilst the state was successful in 40 per cent, with another 30 per cent of cases settled. Enforcement against a state may be problematic, particularly where it is difficult to locate assets which are not protected by state immunity. A failure by the state to pay, however, may deter future investment and increase diplomatic pressure – particularly as ICSID is supported by the World Bank.

STRUCTURING AN INVESTMENT TO MAXIMISE PROTECTION

Although BITs have been around for a long time, many investors and their advisers do not consider them when they are planning and deciding on the best investment structure.

If an investor is not currently covered under a favourable BIT, advice on restructuring the ownership may be needed to obtain coverage and protection.

To enjoy substantive protection under a BIT, generally there must be an "investor" with an "investment" located in the host state.

What is an investor?

The term "investor" is defined specifically in each individual BIT and usually covers both nationals of the contracting states and certain entities incorporated in those contracting states.

It may be attractive to use an investment vehicle incorporated in a jurisdiction that has a favourable BIT with the host state (so-called "forum shopping"), but whether this qualifies for BIT protection depends on the specific wording of the investment treaty.

The treaty may define "investor" solely by reference to the legal formalities of incorporation, so that an investment vehicle would be covered by investment protections in the relevant BIT, however, the treaty may contain a "denial of benefits" clause, so that a mere investment vehicle (without substantial business activities and controlled by foreign nationals) would not be eligible for investment protection.

Host states increasingly call for any joint venture company to be incorporated within their own jurisdiction. Since shares qualify as an investment, a shareholding in the joint venture company may bring the foreign investor within the scope of the relevant treaty.

The following questions may, therefore, be particularly relevant to an investor when considering the investment structure:

- Will an investment vehicle be considered an "investor" under a BIT between the jurisdiction of incorporation of the investment vehicle and the host state?
- Where a subsidiary controls the investment and is incorporated in a different jurisdiction from its parent company, can the parent company bring an investment treaty claim against the host state?
- Can a foreign shareholder of a locally incorporated company in a host state claim investment protection under a BIT between their home state and the host state?

What is an investment?

The term "investment" is also defined specifically in each BIT. Usually, it is widely defined and many BITs describe this as "any assets, directly or indirectly controlled by the investor".

Direct investment would include all tangible and intangible assets, debt, contractual claims and intellectual property rights. Investments may be limited in territorial scope but it is likely that in the event of a dispute a tribunal would consider all relevant economic activity, even if not all aspects of the investment were performed locally in the host state.

Indirect investment would include investments held by subsidiaries, minority shareholders, holding companies or ultimate beneficial owners. A tribunal will carefully consider the wording of the treaty when deciding whether an indirect investment qualifies as a protected investment under the relevant BIT.

Automatic application

The investor need not "elect" for a BIT to apply as this will be automatic, provided that the "investor" and "investment" fall and remain within the relevant definitions. Depending on the extent to which the treaty's terms are considered favourable, the investor may choose to try and obtain additional protections from the host state by inviting the state to be a party to the investment agreement.

SELECTING THE MOST FAVOURABLE BIT

Not all investment treaties are the same and some offer more significant and extensive protection. With careful consideration though, investors can use the right vehicle and BIT to maximise their treaty protection.

Selection of the most favourable treaty will depend on a number of factors, including:

- treaty definitions and restrictions, including those in any ancillary agreements or protocols between the governmental parties;
- availability of most favoured nation protections and the implications under related agreements;
- tax planning considerations in the contemplated investment structure;
- availability of treaty protections where the protected investor holds the target assets indirectly; and
- prescribed formalities in the arbitral and compensation process, including compliance with pre-conditions in asserting claims.

RELEVANT AFRICAN JURISDICTIONS

A list of BITs can be accessed at here.

The UK has BITs with numerous African jurisdictions, including: Benin, Cameroon, Congo, Côte d'Ivoire, Lesotho, Morocco, Nigeria, Senegal, Sierra Leone, South Africa, Swaziland, Tanzania, Tunisia and Uganda.

Investors may wish to structure investments in African jurisdictions through European jurisdictions other than the UK. To take one example, the Netherlands also has BITs with a number of African jurisdictions, including: Benin, Cameroon, Côte d'Ivoire, Ethiopia, Gambia, Ghana, Kenya, Malawi, Mali, Morrocco, Mozambique, Namibia, Nigeria, South Africa, Sudan, Uganda, Zambia and Zimbabwe.

Investors making investments through European jurisdictions should be aware that there are a number of BITs between the EU and African jurisdictions. The EU has concluded agreements with, for instance, Cameroon, Côte d'Ivoire and South Africa.

A number of African countries also have BITs with other African countries, for example, there is a BIT between Nigeria and South Africa. Mauritius' network of BITs (with countries including Congo, Mozambique, Senegal, South Africa and Tanzania) may also be of interest to investors who wish to make investments through Mauritius or Mauritian entities.

CONTACT DETAILS

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