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INVESTMENT TREATY ARBITRATION

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EXPERT FORUM

INVESTMENT TREATY ARBITRATION

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CD: Could you provide an overview of recent trends in the investment treaty arbitration arena? What notable developments would you highlight?

MacKinnon: Disputes related to energy transition are at the centre of the investment treaty arbitration arena, and we expect that trend to intensify in the near future. Over the past decade, climate and sustainable development have been at the top of the agenda of governments, companies and civil society. In this context, many countries have implemented ambitious regulatory regimes to attract foreign investment in the renewable energy sector, while disincentivising the use of conventional fuels. However, governments have not always been fully satisfied with the returns on their investments in renewables. Moreover, recent events such as the coronavirus (COVID-19) pandemic and the Russian invasion of Ukraine have disrupted international energy markets, causing fossil fuel prices to rise, at least for a time. As a result, several countries have enacted regulations seeking to revive their oil and gas industries. In the wake of these regulatory changes, some investors have elected to initiate investment treaty claims.

Triantafilou: The termination of intra-European Union (EU) bilateral investment treaties (BITs) and the ongoing reform of the Energy Charter Treaty (ECT) have limited the number of new treaty cases in Europe, notwithstanding exceptional scenarios such as the recent UBS and Credit Suisse merger. Other geographic areas, however, including Latin America and Central Asia, continue to generate substantial disputes under investment treaties. The illegal war in Ukraine has generated increasing interest in the operation of investment treaties in occupied territories, as well as the cross-section of investment treaty rights with rights under international humanitarian law.

Morris: There have been several potentially significant recent developments regarding investment treaty arbitration. The debate over the interaction between investment treaty protections and the state's right to regulate in the environmental and climate change policy space appears likely to continue playing a central role in the larger discussion over investment treaty arbitration and potential reform. For example, the ECT modernisation process faced unexpected roadblocks when the European Commission (EC) failed to gain the consensus of EU member states in support of the modernised text – and since then, multiple EU member states have announced their intention to withdraw from the ECT. In the US, the Supreme Court issued its decision in *ZF Automotive US, Inc. v. Luxshare, Ltd*, which held that US discovery under 28 USC section 1782 is not available for

international arbitration, although litigation continues over whether this includes arbitration under the International Centre for Settlement of Investment Disputes (ICSID) Convention.

Rodriguez: In Latin America, one of the most active geographical areas for investment arbitration, we are starting to see the increase of investment disputes resulting from the recent political shifts in the region. For example, Xiomara Castro Sarmiento became president of Honduras in 2022 with a socialist agenda and the promise to undo a number of the more conservative policies of her predecessor. Honduras is now facing seven investment arbitrations, five of which were commenced in 2023. A similar increase in the number of investment arbitrations is expected as a consequence of the political shifts in Colombia, Chile and Peru. We are also seeing an increase in transparency in investment arbitration with the new ICSID rules and the required disclosure of the identity of third-party funders in particular. The new rules seem to have reached a fair balance, as claimants have not had any issue complying with the new disclosure requirements for proceedings funded by third-party funders.

Kurek: The war in Ukraine has brought into focus potential investment treaty claims related to armed conflict arising out of the destruction or harm caused to investments in Ukraine, including territories annexed by Russia. Similarly, the Ukraine war has also given rise to disputes with respect to Russian investments abroad that have been affected by global sanctions and other measures adopted by states around the world in response to Russia's invasion of Ukraine. The recent global economic instability, including the ongoing energy crisis and recent events in the financial sector, including the collapse of a number of banks in Europe and the US, have had a significant impact on the investment arbitration landscape, both with respect to new claims that have already been initiated, as well as many investors seeking to mitigate investment risks by proactively restructuring potentially affected investments.

CD: What steps do companies need to take in relation to structuring their overseas investments to ensure they qualify to receive investment treaty protection?

Triantafilou: Companies should consult with qualified counsel to ensure that their corporate structure attracts the protections of one of more investment treaties. This can be done at fairly low cost, consistent with tax planning, and can provide substantial downside protection.

Morris: When considering a new investment, or reassessing an existing investment, companies can work with specialist counsel to identify whether those investments are covered by an investment treaty between the company's country of incorporation and the host country. If not, counsel can identify investment treaties between the host country and other countries that may be attractive for purposes of establishing a holding company to hold the investment. As part of this process, it is important to consider the definition of investment and investor under the available investment treaties, as well as the substantive protections and dispute resolution mechanisms available. Companies will also want to consider the tax implications of inserting such a holding company when choosing among available investment treaties.

Rodriguez: Investment arbitration should be a key consideration at the moment of making cross-border investments. Before investing in a particular country, a multinational company must include in its due diligence process an analysis of the investment protection mechanisms available in the host country at the same time factors such as country risk, business climate and political stability are evaluated. That is the moment to decide where and how to incorporate and base the corporate investor. This due diligence process is necessary not only for companies that are bidding for governmental contracts, but also for companies that are making private investments in a foreign country. These private investments are subject to government measures that could trigger the protections available under most bilateral treaties. With respect to restructuring, post-dispute restructuring is not an effective strategy to invoke the protection of a bilateral treaty. Therefore, companies need to implement their restructuring plan at least before there is a dispute ripe for arbitration. Second, a restructuring plan must satisfy the treaty requirements to qualify as an investor. Incorporation in a country with a bilateral agreement with the host nation, without more, may not be enough. Third,

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companies must give due consideration to the different business and non-dispute-related benefits available in different jurisdictions and conduct a thorough analysis of the countries with bilateral agreements with the host nation.

Kurek: Investors are free to structure or restructure their investments in a manner that ensures that there is adequate protection by applicable BITs, provided a restructuring takes place before a dispute arises or can reasonably be foreseen. Investors may do so by adopting corporate structures that hold investments via affiliates or holding companies of a particular nationality. In devising such investment structures, it is not only important to ensure that the investment benefits from the best available BIT protections, noting that some BITs provide more extensive protections than others, but also that the structure does not fall foul of restrictions contained in some BITs. Such restrictions include denial of benefits clauses or restrictive definitions of protected investors that may deny the protections of the relevant BIT to certain categories of investors, such as mailbox companies with no economic connection to their notional BIT home state.

MacKinnon: Ensuring adequate investment treaty protection is an important and potentially complex matter. Doing so naturally requires a review of the provisions of the potentially applicable treaties entered into by the host state. Attention should be paid not only to the substantive protections contained in those treaties, but also to procedural matters. Often, differences that may seem minimal can generate different interpretations. Additionally, investors must keep abreast of developments in the jurisprudence which may affect the treaty protections they enjoy, as illustrated by the path-breaking decision in *Achmea*. Finally, investors should bear in mind that some arbitral tribunals look suspiciously upon the 'treaty structuring' process, whereby investors structure their investments with a view to obtaining better treaty protection. This

"Investors should negotiate with the host government in the context of the investment arbitration provisions of the applicable treaty."

Francisco A. Rodriguez, Reed Smith LLP

is especially the case when a dispute has already crystallised, in which case it may be too late to restructure in order to obtain treaty protection.

CD: What advice would you offer to investors on deciding whether and how to initiate an investment treaty arbitration process?

Morris: As with any potential litigation, the first step is to identify the investor's strategic goals. For example, if the investor's goal is to reinstate a licence or to invalidate a domestic law, the investor will likely need to look to domestic legal remedies to achieve these goals. By contrast, investment treaty arbitration may be the better tool where the investor is primarily focused on compensation or where domestic legal remedies look like they will be ineffective, such as due to concerns about the duration of local court proceedings or the remedies available under domestic law. In terms of how to initiate an investment treaty arbitration, the investor will want to consider with its lawyers, and potentially also government relations advisers, how best to position the claim to maximise the pressure on the host country's government and thus the potential for an early favourable resolution.

Rodriguez: Investors should negotiate with the host government in the context of the investment arbitration provisions of the applicable treaty. Most treaties have pre-filing provisions that require negotiation prior to the commencement of arbitration proceedings. These provisions have specific requirements that must be satisfied. Investors should negotiate within the framework of these provisions. Frequently, companies try to amicably resolve a dispute for months before sending a notice of intent to commence arbitration proceedings or trigger letter, which usually require three or six months of pre-arbitration negotiation. The more effective strategy is usually to start the negotiation process with an amicable but treaty-compliant letter, making clear that while the investor is willing to negotiate in good faith, it is ready to escalate the dispute to an investment arbitration if necessary.

MacKinnon: Before initiating the investment arbitration process, it is essential to thoroughly study the facts and the law, in order to determine whether a persuasive investment treaty claim can be made. This involves gathering all of the relevant documents, both good and bad, and speaking to potential witnesses. It also involves consulting with outside counsel and oftentimes with technical and quantum experts to get their objective views of the strengths and weaknesses of the potential claim. Treaty breaches are difficult to prove, and parties should make sure to receive a clear-eyed assessment of

their claims and the quantum of their damages before embarking on an investment treaty arbitration process. This is no time to approach matters with 'rose-coloured glasses'.

Kurek: The decision to initiate investment arbitration proceedings should not be taken lightly and only after consideration of the pros and cons and merits of such proceedings, including considerations regarding the potential enforcement of any future arbitral award. In this respect, it is also important that investors consider the potential consequences of initiating proceedings against a state, especially if the investor still has other investments in that state or intends to make other investments in that state in the future. Investors should also consider whether there is any scope for the dispute to be resolved via alternative means, such as via political or commercial avenues. It is also important for investors to understand that investment arbitrations often involve lengthy proceedings, including frequent jurisdictional battles with respondent states, and generally require a significant time and financial commitment by investors. States are also often less willing or able to settle proceedings compared to commercial counterparties, making it more likely that a dispute will go all the way once it has been commenced.

Triantafilou: The process is always made more efficient when qualified counsel is engaged to provide guidance from the beginning. Investors should carefully research the lawyers they hire for investment treaty claims, as the process differs materially from ordinary civil litigation.

CD: What are some of the key considerations when preparing for investment treaty arbitration?

Kurek: Investment treaty arbitrations rarely arise in isolation, and it is therefore important for investors to prepare for, and frame, their investment claims in a manner that is consistent with their global disputes strategy. Moreover, when preparing for investment treaty arbitration, thorough preparation, including a detailed understanding of the underlying facts, collation of key evidence, and careful analysis of jurisdictional and merits issues is key. This includes considering whether any additional evidence is required that should be obtained before proceedings are commenced. Investors should also consider the risk of potential counterclaims by respondent states, in particular with respect to treaties that seek to impose obligations on investors. Finally, investors should integrate enforcement considerations into their strategy from an early stage, including preliminary due diligence on enforcement or

consideration of available insurance and litigation funding options.

Triantafilou: It is essential to identify and preserve relevant evidence appropriately, which usually is done more effectively with guidance from qualified counsel. It is also important to plan carefully and realistically for the time and resources required, which can be significant. Finally, one must always keep in mind the shifting political and commercial dimensions of the dispute for purposes of devising the long-term strategy, including angles and timings for a potential settlement.

MacKinnon: Adequate preparation prior to the commencement of any arbitration is essential. This is especially true in the context of investment cases, which often involve complex factual and legal issues. There are several steps that parties should consider taking in preparing their case. First, they should conduct a detailed analysis of the applicable investment treaty or treaties and familiarise themselves not only with the substantive protections contained therein, but also with any procedural provisions, including those relating to the pre-arbitration process. Second, parties should take prompt steps to collect, evaluate and preserve all relevant information related to the investment, including reviewing relevant contracts, correspondence and financial records, and examining applicable laws and regulations. In this regard, it is never too early to begin studying damages issues, which can make or break an investment treaty claim. Third, it is important to consult with outside counsel, as well as potential experts. Investment arbitration is a complex area of law, and having lawyers and consultants who are familiar with the specific legal frameworks and procedural rules governing investment disputes will enable parties to navigate the process more effectively.

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Epaminontas E. Triantafilou, Quinn Emanuel Urquhart & Sullivan, LLP

Rodriguez: One of the key considerations in preparing for investment arbitration is whether the governmental conduct at issue rises to the level of a treaty violation. Most treaties protect investors from discriminatory governmental measures in favour of local companies or companies of other nations, expropriation without compensation or measures that fall below the standard of fair and equitable treatment. These are serious allegations that are better adjudicated in an international process with the due process protections established in most investment treaties. There are other violations that do not rise to this degree and that are better decided in the national courts. Companies need to also consider the cost of an investment arbitration and whether, from a business perspective, the arbitration would be self-funded or funded by a third-party funder that can finance the proceedings, including attorneys' fees and costs. The process to obtain third-party funding may take anywhere between three to five months.

Morris: When preparing for investment treaty arbitration, an investor should work with counsel to identify early on the applicable investment treaty or treaties to be aware of any procedural preconditions for bringing a claim and any potentially applicable statute of limitations. Such provisions may have important implications for the timing and scope of any claim. Another key consideration is developing and preserving the factual record. It is important to document the course of interactions with government officials, especially once a dispute seems likely, and to ensure that these records are maintained, especially where they are held by multiple individuals. Where an investor relies on government representations or other aspects of the legal regime in making its investment, it is particularly important to document these as support for any legitimate expectations.

CD: Are there any common factors that typically underpin a successful or failed investment treaty arbitration? What lessons can parties learn from recent decisions?

Triantafilou: The result of an investment treaty arbitration, and any legal process for that matter, hinges primarily on the quality of the evidence. However, the experience and ability of the legal representatives presenting the case, and the tribunal members deciding it, can be equally significant. Parties to arbitration are empowered to choose both their counsel and arbitrators. It is essential to approach those choices with the respect they deserve, as they can make a difference in the efficiency of the proceedings, the consideration of the evidence and the quality of legal reasoning involved in resolving the dispute. A failed arbitration

is one which could have had a different outcome if it had been conducted better.

MacKinnon: There is no 'one size fits all' approach to investment arbitration. The outcome of the claim will depend to a large extent on the particularities of the case. However, there are some common factors that often contribute to the success or failure of a dispute. First, the strength of parties' respective factual evidence is key. While lawyers naturally tend to place heavy emphasis on legal analysis and argument, weaving a persuasive factual narrative is often just as important, if not more so. Second, claimants must understand not only the international law principles embedded in the relevant investment treaty or treaties, but also the legal system and policies of the host state. Investment treaty arbitrations often involve important issues of local law, and it is often essential to have the support of skilful local counsel to address these issues, in addition to an international firm specialising in treaty arbitration. Finally, parties should always bear in mind that, as the maxim goes, an arbitration is only as good as its arbitrators. Accordingly, parties should take great care in the arbitrator selection process, considering not only the experience and expertise of potential candidates, but also the much-underrated quality of 'availability'.

"Enforcement against assets held by state-owned companies as an alter ego of the state may only be possible in exceptional circumstances."

Philipp Kurek, Kirkland & Ellis

Rodriguez: The selection of the arbitrators is fundamental in any arbitration. Investment arbitration is a field in which a number of scholars and practitioners have very well-defined notions and philosophies about the responsibilities of states and the scope of the fair and equitable obligations. The participation of arbitrators with preconceived notions that are relevant to the dispute has the potential to undermine the integrity of the arbitration process and should be avoided or at least minimised. Another factor is the jurisdiction of the investment arbitration tribunal. A high percentage of investment arbitration cases are dismissed for lack of jurisdiction because the company does not satisfy

the requirements to be considered an investor under the treaty. Parties should focus on the jurisdictional allegations and make sure that all the requirements are satisfied in the request for arbitration.

Morris: Although some investment treaty arbitrations turn on the interpretation of specific provisions in the treaty, most commonly it is the factual record, as framed and argued by counsel, that determines the outcome of a claim. For this reason, it is particularly important to marshal all the documentary evidence available to create a compelling narrative and to carefully consider whether and how to supplement that record with witness evidence. The outcome of certain kinds of claims, such as fair and equitable treatment claims based on changes to the regulatory regime, may be particularly sensitive to the composition of the tribunal. Recent decisions that analyse the fair and equitable treatment standard in similar factual circumstances may be especially valuable in crafting effective arguments in the case at hand.

Kurek: Thorough preparation is key. When states take actions that threaten, harm or destroy an investor's investment, there is often a need to take immediate action to seek to mitigate losses resulting from such actions. However, it is important that any such steps do not undermine a subsequent investment treaty claim. For example, investors should consider carefully whether any action they may wish to take on a national level may fall foul of 'fork-in-the-road' clauses in applicable BITs that may preclude BIT claims being pursued via international arbitration. Similarly, any corporate restructuring after the dispute has arisen or become reasonably foreseeable may do more harm than good and should be considered very carefully. Finally, it is important that any treaty claim is aligned with the investor's global disputes strategy, including any related disputes with other parties or parallel commercial and political dispute resolution efforts, ensuring maximum protection on all fronts to achieve the investor's overall commercial goals.

CD: How would you characterise the challenges involved in enforcing an arbitral award against sovereign and state entities?

Kurek: Enforcing arbitral awards against states presents unique challenges that need to be considered carefully from the outset. Unlike private parties, states benefit from sovereign immunity that can be a powerful shield to resist enforcement. The exact scope of such immunity varies from jurisdiction to jurisdiction. Depending on the jurisdiction in which enforcement is sought, enforcement may only be possible against certain categories of assets, often only assets that are

commercial in nature. Enforcement against assets held by state-owned companies as an alter ego of the state may only be possible in exceptional circumstances. In addition, investors seeking to enforce arbitral awards against states may also need to navigate economic sanctions, which may further complicate the enforcement process. It is therefore important to identify potential assets, ideally outside of the state against which enforcement is sought, at an early stage so as to formulate a comprehensive enforcement strategy to navigate these issues.

Rodriguez: A number of awards are paid voluntarily. When enforcement proceedings are necessary, there are a number of challenges that have to be considered. Property owned by sovereign countries is subject to a number of protections. As such, the first challenge is identifying property that can be attached. The second challenge is actually formally serving the foreign government in an attachment action. It can take anywhere between six to 12 months to formally serve a government with an attachment action in the US. The advantage is that most courts are quite comfortable enforcing investment arbitration awards after any annulment proceeding has been completed and do not allow award debtors to make substantive arguments that are not directly related to the execution process.

Morris: The challenges involved in enforcing an arbitral award against sovereign and state entities have been increasing in recent years, as more respondent states are routinely challenging arbitral awards and either delaying payment until the set aside process is complete or simply refusing to comply voluntarily. At the same time, investors have become more sophisticated and creative in their efforts to locate and attach sovereign assets. The enforcement of intra-EU investment awards is a particularly interesting area to watch in this respect, investors have begun enforcing awards against Spain, for example, in a variety of jurisdictions, which has led to anti-suit injunctions by Spain and anti-anti-suit injunctions by investors.

MacKinnon: Enforcing investment arbitration awards presents unique challenges. The main issue is what role local courts play in enforcing such awards, reflecting a complex intersection of international law and national laws. Under the 'self-standing' system created by the ICSID Convention, awards are subject to automatic recognition by the contracting parties, which are obliged to recognise them as if they were a final judgment of the contract parties' own courts. However, states have occasionally challenged the enforcement of ICSID awards, and, in some cases, local courts have been receptive to such challenges. Investment treaty arbitrations that are not conducted under the

auspices of ICSID are generally subject to annulment, as well as recognition and enforcement, in much the same way as are other international arbitration awards. One possible aspect to consider in this regard is the effect that *Achmea* could have on the enforcement stage of investment treaty awards, including whether *Achmea* could signal a greater judicial willingness to scrutinise awards even outside the context of intra-EU bilateral investment treaty claims.

Triantafilou: The chances of enforcing an award against a sovereign can vary with the type of award, and even more with the type of sovereign. Generally speaking, award enforcement has to respect the limitations imposed by principles of sovereign immunity and to overcome the limited legal challenges against arbitral awards available under most national laws and international conventions, such as jurisdictional error, violation of public policy, and so on. Even after such challenges have been dealt with, enforcement is meaningless without assets to enforce against. For instance, certain sovereigns, which face substantial legal exposure under earlier international arbitral awards, have adopted highly sophisticated approaches to shielding assets from enforcement.

CD: What are your predictions for investment treaty arbitration over the months ahead? To what extent do you expect to see an uptick in cases?

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Rodriguez: We will continue to see an increase in the number of investment arbitrations filed given the political shifts that we are seeing in some of the key regions and the filing of the last legacy cases arising from the North American Free Trade Agreement (NAFTA). The real question is whether the movement to amend or curtail investment arbitration is able to reach its objectives. NAFTA is an example of an amendment effort that significantly limited the availability of investment arbitration. In the US, we continue to see a number of politicians denouncing the system of investment arbitration, as a system

designed to benefit multinational companies to the detriment of developing nations. Elizabeth Warren, senator for Massachusetts, for example, has recently criticised some of the recent investment arbitrations filed against the new government in Honduras by American investors seeking billions of dollars in lost profits. Whether this movement succeeds is uncertain and will depend to some extent on whether the negative campaign against investment arbitration is answered with statistics showing that investment arbitration has resulted in a significant increase in the amount of direct foreign investment in the developing world.

Morris: Despite criticisms and ongoing reform efforts, investment arbitration continues to be an essential tool to protect foreign investors' investments, and the number of new claims remains consistent with recent trends. Recent regulatory interventions by various different states, for example in response to banking failures or other financial crises or in furtherance of climate change policies, may well give rise to future claims. Resource nationalism, fuelled by national security concerns and the transition to green energy, is another area where current or future government measures could affect foreign investment and lead to investment arbitration claims. And the Russian invasion of Ukraine has already started to generate investment treaty arbitrations. In all, an uptick in cases over the coming months would not be at all surprising.

MacKinnon: At present, there has been something of a resurgence of populist movements in various regions, including Latin America. Several governments have announced plans to nationalise key sectors such as energy, telecommunications and retirement pensions, either through direct expropriation or through regulatory measures with a similar effect. These measures could generate investment disputes.

Triantafilou: Investment treaty arbitration will continue to evolve and perform its key function, which is the supranational, depoliticised legal protection of legitimate investors and their lawful investments. There is no doubt that new and complex disputes will continue to challenge the standard conception of the legal framework of treaty arbitration across various areas – from the assignment of treaty rights to the core notions of 'investment' and 'territory'. Such a complex system is not susceptible to easy predictions, but it seems reasonable to expect that case numbers will remain high during this year and next.

Kurek: Investors have become increasingly alive to the issue of BIT protection, more savvy about structuring their investments in a manner that

affords them such protection, and prepared to take decisive action to enforce their rights against states when necessary. With the war in Ukraine entering its second year, it is likely that the continuing conflict and resulting destruction, as well as the wider economic implications of the war, including with respect to sanctions and the global energy crisis, will lead to additional disputes and treaty claims over the months ahead. In addition, it is likely that further claims will emerge from the 2023 banking crisis. It is therefore to be expected that the current geopolitical turmoil will lead to a significant number of new treaty claims in the near future. CD