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KNOW THYSELF: PRACTICAL STRUCTURING OF INTERNATIONAL INVESTMENTS

In ancient Athens, the aphorism "Know Thyself" was inscribed on the wall of the Temple of Apollo. Remarkably, almost 2500 years later, the same admonition applies to those seeking to structure new foreign investments today.

The 2014 Tribunal award in *Lao Holdings. v. Laos*[1] followed this Athenian motto. Lao Holdings, an Aruba company, had casino investments in Laos originally owned by a Macau company. In January 2012, the Macau Company transferred its casino investments to Lao Holdings. A dispute arose between the Macau company and Laos over whether changes to the taxation regime in Laos violated the investment agreement. In March 2012, the Lao Government breached its agreement with the Macau company and imposed the new taxes. Lao Holdings initiated an arbitration claim against Laos under the Netherlands-Laos bilateral investment treaty. Negotiations over concerns about a change in policy took place between the Lao Government and the Macau Investment in late 2011.

Generally, investment treaties provide that a claim can be brought by an enterprise that has the nationality of one of the treaty parties against the other treaty state. There was no dispute that Lao Holdings was actually incorporated in Aruba, a part of the Netherland Antilles. The territory of the Netherland Antilles is covered by the terms of the Netherlands – Laos bilateral investment treaty. The treaty made clear that investments from Aruba were covered.

Laos asserted that Lao Holdings was not a national of the Netherlands at the time the claim arose. Laos claimed that the dispute really arose before the January 2012 transfer to the Aruba company because the investor knew that a tax change would occur. Laos claimed that no arbitration could take place as the dispute arose before the transfer. Against these assertions, Lao Holdings claimed that the dispute only arose after the Lao Government imposed the new taxes.

The Tribunal had to consider the question of when the treaty dispute arose to confirm its jurisdiction. The *Lao Holdings* Tribunal concluded that the legal dispute occurred after the transfer. Thus the Tribunal had jurisdiction to consider the claim.[2] In coming to its decision, the *Lao Holdings* Tribunal stated that it would oppose manipulation of the treaty system to propagate a claim. The Tribunal referenced the Tribunal's statement in *Venezuela Holdings v. Venezuela*:

> … the Tribunal considers that to restructure investments only in order to gain jurisdiction under a BIT for such disputes would constitute…, "an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs…[3]

1 *Lao Holdings N.V. v. Lao People's Democratic Republic,* Decision on Jurisdiction. ICSID Case No. ARB(AF)/12/6, February 21, 2014.

2 *Lao Holdings.* at ¶83.

3 *Lao Holdings* at ¶70 quoting *Venezuela Holdings B.V. and others v. Bolivarian Republic of Venezuela* (formerly *Mobil Corporation and others v. Venezuela*), ICSID Case No. ARB/07/27, Decision on Jurisdiction, 10 June 2010 at ¶205.

The *Lao Holdings* Tribunal noted that the jurisdictional challenge in the *Venezuela Holdings* claim was based on abuse of process and was not a challenge to the temporal coverage of the treaty.[4] In an interesting turn, the *Lao Holdings* Tribunal stated that there could have been a different result had Laos raised a different jurisdictional objection. The Tribunal identified the possibility of Lao Holdings engaging in an abuse of process. The Tribunal described abuse of process in the words of the *Phoenix Action. v. Czech Republic* Tribunal, as:

> [T]he Claimant made an "investment" not for the purpose of engaging in economic activity, but for the sole purpose of bringing international litigation against the Czech Republic. This alleged investment was not made in order to engage in national economic activity, it was made solely for the purpose of getting involved with international legal activity. The unique goal of the "investment" was to transform a pre-existing domestic dispute into an international dispute subject to ICSID arbitration under a bilateral investment treaty. This kind of transaction is not a bona fide transaction and cannot be a protected investment under the ICSID system.[5]

However, the *Lao Holdings* Tribunal noted that since Laos had not brought an abuse of jurisdiction argument, it could not rule on that issue.[6] After the dismissal of the jurisdictional challenge, the disputing parties reached a settlement. The terms of the settlement were not publically disclosed.

The *Lao Holdings* award differs from an earlier decision involving a similar investment approach applied in Bolivia. In *Aguas del Tunari*,[7] American engineering services company, Bechtel Corporation, purchased the fresh water concession for a region in Bolivia. The purchase was made through a Cayman holding company. The water concession contract did not permit Bechtel to transfer its ownership in the concession without the prior consent of the Bolivian government. A dispute over the terms of the contract arose and, in light of the eventual contractual dispute, it did not appear likely that Bolivia would consent to any changes.

The investor was unable to resolve its dispute with Bolivia and it believed that it could not obtain an impartial result through the courts in Bolivia. However, there appeared to be no opportunity to hold an investor-state arbitration as Bolivia did not have a treaty with the United States, where Bechtel was based, nor with the Cayman Islands. It appeared that Bechtel could not obtain a fair day in an international court. After considering the situation carefully, and before Bolivia took steps to cancel the contract, Bechtel had a creative solution. Even if it could not transfer its ownership interest in the water concession, Bechtel could migrate the nationality of its Cayman Islands holding company to Luxembourg. Subsequently, Bechtel had the migrated company acquired by wholly-owned Netherlands subsidiary.

Exporting the indirect investor was not inconsistent with the concession agreement. As a result, Bechtel was able to rely upon the provisions of the Netherlands-Bolivia bilateral investment treaty to start an investor-state arbitration for actions that arose since the migration. While the *Aguas del Tunari* Tribunal clearly did not support the concept of treaty forum switching, it was obliged to agree that Bechtel's tactic was permitted: a result that did not please the Republic of Bolivia.

The need to thoughtfully structure foreign investments is critical. These requirements have consequences on an arbitration's eventual success. Both the *Lao Holdings* and the *Aguas del Tunari* decisions make clear that investment transfers are complex. It is essential that a Claimant know itself and how to establish its nationality effectively. *Aguas del Tunari* is clear that a Claimant cannot change its nationality to commence an arbitration claim after the treaty breach has occurred. However, thoughtful investment structuring can provide investment protection and access to international arbitral forums. Clearly these are matters that require careful thought and attention before an arbitration is commenced.

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4 *Lao Holdings* at ¶71.

5 *Lao Holdings* at ¶69 quoting *Phoenix Action Ltd. v. Czech Republic* ICSID Case No. ARB/06/5, Award, 15 April 2009 *at ¶142*

6 *Lao Holdings* at ¶¶78 – 81.

7 *Aguas del Tunari S.A. v. Republic of Bolivia*, Decision on Respondent's Objections to Jurisdiction, ICSID Case No. ARB/02/3; 2005 WL 3619910 (October 21, 2005).

Practical Structuring Advice

1. **Think carefully about holding companies**
   The selection of the nationality of the holding company location should be made before the investment is made. Considerations of taxation and investment protection can be most easily considered before the actual investment is made.

2. **Mention that you are a foreigner in your contracts and letters**
   If the investment requires a contract with a foreign government, or government entity, agency or enterprise, it is very helpful to make mention of the foreign holding company and its place of incorporation in the contract itself.

3. **Creative structuring can help – even after the investment has been made**
   The definition of what constitutes a protected investment is very broad under international investment agreements. For example, the North American Free Trade Agreement sets out a definition of investment that is more than a page and a half long and which includes more than the staples of investment (companies, partnerships, real estate and shareholdings) but also extends to intra-corporate loans of more than three years, joint ventures, debts, contingent interests in proceeds or assets, and intellectual property.

4. **It may not be too late to take steps when the storm is approaching**
   Once a foreign investment has been made, there is often a good amount of time before sovereign concerns begin to appear. In *Aguas del Tunari*, there was enough time for the company to take steps from the "first signs of rain" that permitted the corporate changes to occur before the "thunderstorm". Even if the horizon looks stormy, there often still is sufficient time to take steps to enhance international protections under an investment protection treaty.

5. **Use the right words in your contract**
   Even if there is no bilateral investment treaty in effect, appropriate arbitration language in public-private partnerships and other contracts can confirm that access to investor-state arbitration is available. It is important that this language is clear if it is to be enforced.

6. **Make hay while the sun shines**
   This old adage is as good now as ever. Experienced foreign investors take action when they see rain on the horizon.

7. **Get the right legal advice**
   It is clear from the Lao Holdings decision that care must be taken in investment structuring decisions. Always obtain knowledgeable legal advice when concluding the investment. Such steps must be carefully considered and always require the careful review of an international lawyer, specialized securities and taxation counsel and a qualified attorney from the state of the investment to ensure that all proper formalities are observed.

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