

ADVISORY | Arbitration

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Is your Company Adequately Protected From the Continuing Nationalization of Foreign Investments in Venezuela and Other Countries?

The Venezuelan Government has been following a policy of increasing absorption of private industry by the State. It has directly or indirectly nationalized a broad spectrum of investments, both foreign and domestic, including investments in the oil and gas, agriculture, consumer goods and banking sectors. It has also taken other adverse measures against investors, often as a prelude to expropriation. Recently, President Chávez ordered the nationalization of a supermarket chain because the company allegedly failed to observe price controls imposed by the Venezuelan Government.

Other States in Latin America, Eastern Europe and Asia are following similar policies. They have adopted measures that directly expropriate foreign investment, substantially impair the value of the investment or the investor's control over it, or renege on commitments made to foreign investors to induce them to make the investments.

Bilateral and multilateral investment-protection treaties protect qualified foreign investors and their investments from adverse measures by host States. If your company's investments in Venezuela and elsewhere are not protected by adequate investment treaties, your company may have no effective remedy in the event of nationalization or other governmental measures adversely affecting those investments. (Some States have also adopted internal laws to protect foreign investment. The scope of those laws is often controversial and raise issues that cannot be addressed here.)

Today there are more than 2,500 bilateral investment treaties involving most countries in the world, as well as an increasing number of multilateral agreements containing provisions on investment protection. Venezuela has entered into more than 28 investment treaties with other countries, but some of those treaties are not (or no longer) in effect. There is no investment treaty between the United States and Venezuela.

Investment treaties typically provide that each contracting State is obligated to afford to the investors of the other contracting State: (i) treatment that meets substantive international standards of protection, and (ii) access to international arbitration of disputes concerning the investment.

Many investment treaties require the following substantive protections:

- Prohibition against expropriation of investments or measures having equivalent effect unless the measures are taken for a public purpose, on a non-discriminatory basis, and against prompt, adequate and effective compensation consisting of fair market value;

- Obligation to afford fair and equitable treatment, which several arbitral decisions have interpreted to include the obligation to provide a stable and transparent legal and business environment and the obligation not to frustrate the investor's legitimate expectations;
- Obligation to afford full protection and security to the investment;
- Prohibition not to impair by arbitrary or discriminatory measures the management, maintenance, use, enjoyment or disposal of foreign investments;
- Prohibition to afford to foreign investors or investments treatment that is less favorable than that accorded to companies of the host State or a third State; and
- Prohibition against imposing restrictions on the transfer of funds, including the repatriation of dividends, loans and investments.

Most investment treaties provide for the settlement of investment disputes by means of binding international arbitration. Often the investor is given a choice of submitting a dispute to institutional arbitration (administered by an institution such as ICSID, ICC or SCC) or *ad hoc* arbitration conducted under rules such as those elaborated by UNCITRAL. The arbitral tribunal normally has the power to award damages in case of breach of the treaty.

Although most investment treaties contain similar provisions, they do not necessarily cover investors or investments with equal breadth or afford the same level of protection to the investments they cover. For example, some treaties impose more stringent requirements than others for an investor or an investment to qualify for protection. Some treaties require substantive standards of treatment that are more protective than the standards required by other treaties. Each investment treaty must be examined on its own and the degree of protection it affords must be compared with the degrees of protection provided by other available treaties.

Any company contemplating an investment abroad should study the investment treaties that may be in force for the host State and structure the investment accordingly. Generally, a company would be well advised to use an investment vehicle incorporated in a State that has entered into a highly protective investment treaty with the host State. A U.S. based company should not simply assume that U.S. investment treaties, if available, offer the highest degree of protection. Investment treaties made recently by the United States are in some respects less protective of investments than past U.S. treaties or treaties made by other countries.

As new investment treaties come into force, companies should keep the structure of their overseas investments under periodic review, especially in the case of investments that were initially structured without considering the availability or relative merits of investment treaties. It is seldom too late to restructure an investment to increase the degree of protection. But an investor should not wait for clouds to gather on the horizon before buying a good umbrella, and should certainly not wait until it starts to rain. The longer an investor waits to take protective action, the greater the likelihood that the host State will challenge the validity or effects of the restructuring or question the investor's motivation. Even if such charges have no merit, they will increase the costs, delays, and risks of arbitration.

As the recent actions of the Venezuelan Government illustrate, foreign investors in Venezuela and elsewhere need the protection afforded by investment treaties. We urge our clients to pay close and immediate attention to this issue. We have extensive experience in counseling clients on investment-treaty protection, as well as representing them in investment-treaty arbitration.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our arbitration practice group:

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