RESOURCE NATIONALISM AND INVESTMENT TREATIES – STRUCTURING YOUR PROJECTS TO LIMIT RISKS

15 APRIL 2020 • ARTICLE

This briefing explores some of the risks of resource nationalism and the structuring of projects to benefit from the protection of an investment treaty. This can help to mitigate risks associated with resource nationalism and ensure that there is a pathway to recourse should your project be affected by it.

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WHAT IS RESOURCE NATIONALISM?

Resource nationalism ("RN") arises when a nation changes its internal policies with respect to natural resources with the intention of benefiting the nation, to the detriment of an external investor's economic benefit. The policy changes can be wide-ranging, from changes to rules regarding taxes and repatriation of profits to, in the extreme, expropriation of a project without compensation.

Sometimes, such policy changes are applied *after* an investment has been has been made in a host nation, changing the cost/benefit analysis investors have undertaken. In those circumstances, it will often be difficult if not impossible to recoup any investment through a sale or similar action as the project may be worth considerably less than anticipated due to the policy changes. While most often associated with natural resources projects such as oil & gas, mining, and soft commodities, RN can also affect other industry sectors such as energy, including the growing renewable energy sector.

WHO DOES IT AFFECT?

Historically, RN was most often associated with politically turbulent and resource-rich countries where projects have been so commercially successful for an external investor that there is a political impetus to intervene in the deal, on the basis that the original deal agreed was a bad one. However, RN is now seen in other areas and sectors of national importance even if the associated project has yet to achieve a significant level of commercial success.

RN therefore affects both profit-making producers as well as explorers for natural resources and other project developers. This can often be when they have reached a critical stage in their project development or moved to a potential exit for investors as this is when the reward for the project company and its owners is most obvious for the host country to see. This could lead to the investor receiving less of a return than agreed, despite potentially taking considerable risk at the project's outset. RN obviously also affects investors in, and lenders to, such projects, particularly as it may not be viable (economically or otherwise) to cancel or unwind any investment and recover funds.

With the potential for an economic slowdown in the coming years, commentators have identified the potential for countries to adopt more protectionist and nationalistic policies as a response. Increased RN could form a part of that trend. A report by a risk consultancy in March 2019[1] identified a trend towards resource nationalism in countries including Russia (which has the most extensive commodity reserves globally and is a G20 economy) and Vietnam (which has a growing renewable energy sector).

RECENT EXAMPLES OF RN

- **Tanzania** – In June 2017, Tanzania introduced a new Mining Act. This required "indigenous Tanzanian companies" to have a minimum of 5% of the shares in mining companies, in addition to a 16% free-carry equity interest for the nation. Among other things, this has resulted in a new deal between Barrick and the Tanzanian Government with a payment of US$300m to settle outstanding tax and other disputes, the lifting of a concentrated export ban, and the sharing of future economic benefits from mines on a 50-50 basis;
- **Democratic Republic of Congo** – In March 2018, DRC modified its mining code to double the nation's free-carry equity interest in mining companies to 10%, with an additional 5% taken on each licence renewal. This was accompanied with a rise in taxes and royalties payable, and a requirement for contractors to be owned by Congolese shareholders;
- **Zambia** – In May 2019, a liquidator was appointed to run Indian mining company Vedanta Resources following an application by the state-owned mining company of Zambia ("ZCCM"). Vedanta Resources and ZCCM currently co-own (79.4%/20.6% respectively) Konkola Copper Mines and the Zambian government have pressed on with a sale process;
- **Sierra Leone** – In October 2019, Sierra Leone revoked (with immediate effect) a licence held by SL Mining to mine iron ore following a rise in iron ore prices. This was ostensibly in response to a dispute over royalty payments. The cancellation of the licence followed a refusal by Sierra Leone to lift an export ban on an SL Mining mine despite an arbitration tribunal ruling that it ought to be lifted;
- **Bolivia** – In January 2020, the head of YLB, Bolivia's state-owned lithium company, explained that the company planned to employ strict limits on foreign investment in the extraction of lithium. This includes a requirement that Bolivians extract and process all Bolivian lithium (presumably through the state-owned entity);
- **Indonesia** – In January 2020, Indonesia banned the export of raw nickel ores. It has been suggested that the intention of the ban was to, *inter alia*, stimulate the domestic processing of ore and force electric vehicle manufacturers to produce their vehicles in the country;
- **Mexico** – At the time of writing, the Mexican government are embroiled in a dispute with Talos Energy over how to allocate ownership over an oil field which straddles one of Talos' oil blocks and an oil field over which Pemex has control; and
- **Mexico** – Again, at the time of writing, Mexico's Regulatory Energy Commission, CRE, is reportedly considering whether, *inter alia,* to unwind grandfathered discounts to transmission costs for renewable energy projects. The elimination of the discount was (again, reportedly) proposed by the country's state-owned utility, CFE, who are said to be also seeking preference over private projects when electricity enters into the national grid.

A REPORT BY A RISK CONSULTANCY IN MARCH 2019 IDENTIFIED A TREND TOWARDS RESOURCE NATIONALISM IN COUNTRIES INCLUDING RUSSIA AND VIETNAM.

MITIGATING THE RISK – WHAT IS A BILATERAL INVESTMENT TREATY?

A bilateral investment treaty ("BIT") is a treaty between two states to protect investments made by a national of either state in a project or other investment hosted in the other state. Each BIT is separately negotiated and therefore different, but the most common provisions include:

- fair and equitable treatment ("FET");
- treatment no less favourable for investors than for host state nationals;
- treatment no less favourable for investors than for nationals of other states ("most favoured nation" treatment);
- protection against, and compensation for, expropriation or nationalisation;
- compensation for losses due to war or other conflict;
- rights to repatriate profits in the investor state's currency;
- "umbrella" clauses to honour the terms upon which an investment is made, therefore elevating contractual commitments to treaty obligations under international law; and
- dispute resolution, often via International Centres for Settlement of Investment Disputes ("ICSID"), allowing affected nationals to claim directly against the host state.

Certain protections may also be available under multilateral investment treaties ("MITs") such as the North American Free Trade Association (NAFTA); the Association of South East Asian Nations (ASEAN) Agreement for the Promotion and Protection of Investments between Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam; or the Energy Charter Treaty ("ECT"). BITs may be accompanied by further treaties on other commercial matters, such as double taxation.

WHO CAN BENEFIT FROM A BIT/MIT?

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BITs and MITs typically apply to nationals of the contracting states,[2] but are often extended on a look-through basis to the ultimate owning nationals and to intermediate holding companies established in a contracting state. This allows a degree of flexibility in structuring ownership of a project to benefit from a BIT/MIT as well as a favourable tax structure (which is commonly a primary concern). In many cases it is even possible to restructure a project after inception (but before a dispute has commenced) to take advantage of a BIT/MIT.

WHAT ARE THE ADVANTAGES OF A BIT/MIT?

The main advantages of a BIT/MIT include:

- it provides protection under international law, which allows an investor to take advantage of well-established principles and a body of case law, over and above any protection existing under local law in the host state and the existing project agreements and licences;
- it usually gives rise to a direct claim against the host state, in addition to claims under local law or against contractual counterparties, which may be different. It may be preferable for an investor to exercise its rights at an international level, and avoid the pitfalls and issues of judicial independence which may be relevant when enforcing locally, particularly against an entity with connections to the host state; and
- it frequently contains provision for ICSID arbitration, which is more easily enforceable than a court judgement or even other arbitration tribunal awards.

ARE THERE ANY RECENT EXAMPLES OF BITS OR MITS PROTECTING INVESTOR INTERESTS?

- *Greentech Energy Systems A/S (and others) v The Italian Republic*

Italy encouraged parties to invest in Italian photovoltaic plants by effectively guaranteeing that incentive tariffs would not change for 20 years. Italy then changed its laws to significantly reduce the incentive amounts. In December 2018, Italy was found to have breached the FET clause of the Energy Charter Treaty and was ordered to pay compensation of €11.9m excluding interest to the claimants[3].

- *Tethyan Copper Company Pty Limited v Islamic Republic of Pakistan*

Pakistan was found to have reneged on an agreement to award a mining licence to Tethyan. The refusal to award the licence was found to breach FET, expropriation and non-impairment clauses of a BIT between Australia and Pakistan. In July 2019, the ICSID Tribunal ordered Pakistan to pay, excluding interest, over US$4bn in compensation to Tethyan notwithstanding that Tethyan had spent only around 6% of that figure on its investment.

- *9REN Holding S.a.r.l. v The Kingdom of Spain*

The claimant invested around €211m in Spanish photovoltaic plants following Spain having decreed that anti tariff revisions would not affect projects registered before a certain date. The claimant's projects were registered before the relevant date, but Spain subsequently reduced the claimant's tariff. Spain's actions were found to have breached the FET clause of the Energy Charter Treaty. In May 2019, the ICSID ordered Spain to pay €41.76m exclusive of interest to the claimant in compensation.

- *Glencore International A.G. (and others) v Republic of Colombia*

When re-negotiating a mining licence, Glencore's Colombian subsidiary agreed with a Colombian mining agency that they would pay lower royalties if they further invested in mining operations. Colombia's public funds agency investigated the agreement and subsequently fined Glencore's subsidiary US$19.1m. In August 2019, the ICSID ordered Colombia to pay the claimants US$19.1m, excluding interest in compensation as they had breached the FET clause of a Swiss-Colombian BIT.

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PROTECTING YOUR INVESTMENT – WHAT NEXT?

If you have not previously considered whether your operations or projects enjoy BIT/MIT protection, or are vulnerable to Resource Nationalism, WFW can undertake a review of your project(s) to help you to identify:

- stage 1 – whether or not you already benefit from a BIT/MIT;
- stage 2 – if not, whether or not you could benefit from a BIT/MIT (or, if yes, whether another BIT may be more advantageous); and
- stage 3 – if desirable, how to (re)structure your project so as to benefit from a BIT/MIT (without losing any existing favourable tax treatment).

In addition, where your project has been affected by potential resource nationalism or governmental action, we are able to analyse whether a BIT/MIT applies and assist you in creating a strategy that takes full advantage of any protections available. This process usually takes place in tandem with seeking local advice and exploring other options for the swift resolution of the dispute, including the use of state-level discussions and diplomatic pressure, or through conventional arbitration.

Our experience includes:

- structuring investments so as to take advantage of BIT/MITs;
- applying BIT/MITs as leverage to prevent threats of nationalisation from turning into reality; and
- BIT/MIT arbitrations and dispute resolution.

[1] https://www.maplecroft.com/insights/analysis/resource-nationalism-rises-30-countries/

[2] Though some (older) BITs may only cover the contracting states, and so can only be enforced on a diplomatic level, since they do not apply directly to nationals of the contracting states.

[3] As a result of the *Achmea* decision by the Court of Justice of the European Union in March 2018, arbitration tribunals appointed in respect of certain intra EU investments and Energy Charter Treaty claims against EU states have regularly had to entertain jurisdictional challenges by member states defending such claims, on the basis that arbitration clauses intra-EU BITs are precluded under EU law. WFW has experience of successfully defeating such jurisdictional challenges in a recent ICSID arbitration against the Italian Republic.

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