HOW TO PROTECT YOUR INVESTMENT UNDER GEORGIA'S GROWING NETWORK OF INTERNATIONAL INVESTMENT TREATIES

International arbitration between states and private investors has been receiving increased attention from both the popular and business media. Perhaps the most illustrious example of an investment dispute was the arbitration between Russia and Yukos energy company of the embattled oligarch, Mikhail Khodorkovsky, which ended in 2014 with a ruling requiring Russia to pay over 50 billion US dollars in compensation. Other famous example is compensations awarded to Ukrainian business-owners who suffered losses due to Russia's annexation of Crimea.

These international cases arose from bilateral and multilateral investment treaties between states, which provide an option for investors to bring their disputes with the states before international arbitration. Investment treaties originated in the post-WW2 period as part of the Bretton Woods international economic system and have since played an important role in facilitating the cross-border flow of capital. There are presently more than 3,000 such treaties in force worldwide.

Few investors and local entrepreneurs know that Georgia also offers the possibility of defending their investments under the international investment treaty regime. In an attempt to foster its investment climate, Georgia has concluded almost 40 such bilateral and multilateral investment treaties. The ever-growing network of these treaties protects investors from potentially unfair interference by the state in private business activities.

That being so, not all investment treaties are created equal. A careful consideration and selection of the applicable treaty regime is required to allow investors to protect themselves from different categories of interference by administrative, judicial, tax and investigative bodies, as well as from unfair and confiscatory legislative and regulatory measures.

What are the advantages of investment treaty protection?

By far the most important guarantee of protection that investment treaties envisage for investors is the right to submit disputes with the state before a neutral international arbitration, instead of in domestic courts. Depending on the terms of the applicable treaty, investors can potentially bring their dispute with the state before the World Bank's International Centre for Settlement of Investment Disputes (ICSID) in Washington D.C., the International Chamber of Commerce (ICC) in Paris, or an ad hoc tribunal of the Permanent Court of Arbitration (PCA) in The Hague.

A major advantage of international arbitration is that it provides for the possibility of obtaining an effective compensatory award for damages. Such awards are enforceable against the assets of the state not only on the territory of that state, but virtually everywhere in the world[1]. Statistics show that respondents frequently comply with arbitration awards voluntarily due to the effective enforcement mechanisms in place. Non-compliance with arbitration awards may result in the deterioration of the state's credit ratings by the World Bank and International Monetary Fund – another factor that incentivizes states to comply with arbitral awards on a voluntary basis.

If an investor does not take advantage of the offer to defend its investment under the international investment treaty regime, it is left with the alternative to resolve its disputes with the state before local courts. For instance, the Law of Georgia on Support of Investment Activities (1996) allowed a foreign investor to bring an investment claim against Georgia in ICSID. However, this option was eliminated after the amendments to the law in 2009, leaving such disputes to the jurisdiction of Georgian courts. While Georgia has carried out a series of judicial reforms, significant challenges remain. There are demonstrable disadvantages to resolving complex business disputes before domestic courts compared to international arbitration. In particular:

- The likelihood of success in disputes against state bodies is low before domestic courts, especially in administrative, regulatory, tax and criminal disputes. In contrast, international arbitration provides a neutral and balanced forum, where private investors have a fair chance to prevail or achieve favorable settlement terms.
- Domestic courts often lack sufficient technical and international law competence and resources to entertain sophisticated economic disputes. In turn, international arbitrators are neutral and specialized in international disputes.
- Even where the investor prevails, domestic courts almost never provide for full compensation for the investor's losses. Domestic remedies often include nothing more than a declaration of invalidity of the disputed administrative act. If at all granted, compensation is usually limited to sunk-costs, often without interest. In turn, in international arbitration, the standard of compensation is full reparation, which fully restores the investor's financial position. The compensation often includes future cash flows (properly discounted) and interest.

Investment treaty protection is also advantageous outside the context of dispute resolution. It increases the investor's bargaining power in negotiations with state bodies and companies, and minimizes the possibility of improper treatment by regulatory authorities. Having access to an effective international dispute resolution mechanism provides a leverage that prevents such disputes from arising in the first place. Engaging in international arbitration with investors sheds a bad light on the investment climate and compels the state to mobilize considerable resources for arbitration costs which the state may prefer to avoid by offering reasonable settlement terms to the investor.

Who can benefit from investment treaty protection?

Investment treaties are primarily designed to protect enterprises that have ongoing business activities or are presently making their investments on the territory of the contracting states. As a rule, investment treaties protect investments is a wide array of economic sectors. This includes energy, mining, agriculture, tourism and hospitality, tech and telecommunications, construction, commodity trading and export-import, distribution, transportation, utilities, media, advertisement, medical services, insurance, banking and finance, as well as entertainment and gambling.

The network of Georgia's investment treaties provides an effective tool of protection not only for foreign investors in Georgia, but also for Georgian entrepreneurs investing abroad or at home. Indeed, some of Georgia's investment treaties provide protection for domestic investors who invest in their own country with a specifically designed corporate structure. However, not all treaties provide for the possibility of protecting such U-turn investments. Domestic investors that would like to come under international protection require a careful consideration of the treaty and arbitral practice and meticulous planning of the corporate structure.

On the other hand, being a foreign investor does not automatically guarantee effective protection under investment treaties. For instance, Russian investors in Georgia do not come under international treaty protection unless they adopt specific treaty planning practices.

Similarly, having a tax efficient corporate structure that involves so-called offshore jurisdictions does not necessarily provide investment treaty protection. For example, enterprises that have participation from British Virgin Islands, Cyprus and the Isle of Man – all relatively popular jurisdictions on the Georgian market – do not automatically fall under Georgia's investment treaties. Enterprises that have such tax optimization structures in place require specialist legal advice ensuring careful planning for treaty protection.

How to plan for investment treaty protection?

The level of protection and the availability of international arbitration to different industries varies depending on the terms of each specific treaty, treaty practice and arbitral case law. For instance, energy companies have a wide range of available options of favorable investment treaty regimes. In turn, commodity-trading, pharmaceutical and gambling enterprises need a more carefully tailored structure in order to enjoy full protection.

To come under such protection, investors must take carefully tailored steps for treaty planning. This entails structuring capital inflow through a well-designed shareholding structure and jurisdictions that enjoy the most favorable treatment under the existing investment treaty regime. The planning must consider not only the obvious terms of the applicable treaties, but also numerous jurisdictional and substantive pitfalls that may emerge from the treaty practice of the contracting states and the vast arbitral case law related to multiple aspects of relevant treaty terms. Most importantly, steps should be taken as a precautionary measure before an actual dispute with the state materializes. After the state takes adverse measures, it is too late as investors are no longer allowed to apply for international protection.

The complexity of the process and the lack of the specialist expertise on the Georgian legal market often prevent local companies from taking advantage of this opportunity. International investment arbitration is a niche sector, in which even well-known international law firms have often limited expertise. Lévy Kaufmann-Kohler (LKK) is a Geneva based boutique law firm which is a market leader in international investment and commercial arbitration. BLC Law Office has recently joined their efforts with LKK's lawyers in advising local and foreign clients on investment treaty planning in Georgia.

Overall, investment treaties can provide a powerful security for a variety of legal risks for international and domestic investors. At the same time, these are complex legal instruments that contain multiple procedural and substantive provisions that require specialist legal knowledge. Investors that take calculated steps have a chance to secure their position under a favorable international regime which enhances protection from the state's adverse interferences and, above all, allows them to submit their disputes to a neutral international arbitration.

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[1] *Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) has 166 contracting states, while the ICSID Convention has 163 contracting states.*