

# CLIENT ALERT

## How Mining Companies Can Mitigate Risks and Protect their Investments, Part I: International Investment Agreements

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*This is the first in a series of articles in The Mining Law Monitor regarding measures that mining companies can take to mitigate the risks of investing in challenging foreign markets. Future articles will address topics such as: the role of concession contracts and other agreements between mining companies and host governments; the significance of national mining laws and other domestic legal measures; and the value of government relations, public relations, and corporate social responsibility (CSR) tools in helping companies manage risks.*

### I. Introduction

Few other commercial enterprises face the types of regulatory and political risks that mining companies face when investing in challenging foreign markets. The often-seen crucible of financial, geological, and political pressures mean that mining companies need to do more than overcome their traditional business, scientific, and engineering challenges. Successful mining companies operating in challenging foreign markets seek to develop additional strategies to actively address and get out in front of the regulatory, policy, and geopolitical risks that foreign governments create for them. The topic of this article – international investment agreements (or "IIAs") – can be one of the most effective tools for mining companies to use to better manage the risks.

Because the horizon for mining investments is long-term – frequently decades-long – these operations can become captive targets for opportunistic regimes. The best geology is often located in some of the most politically difficult regions, such as Central Asia, Africa, and Latin America, a fact that creates a level of threshold uncertainty that firms in other sectors can more readily avoid by simply choosing to invest their capital elsewhere. Mining investments are always capital-intensive, involving enormously valuable physical assets. Moreover, the focus of the investment activity – minerals, ores, other natural resources – frequently have great emotional and political significance for local populations, putting the investing company in the position of possibly appearing as a threat to a country's patrimony and resource sovereignty. In short, investments in such markets come with significant political and country risk, which in turn fosters significant economic risk.

This article lays out what every board member and manager should know to help mitigate risk – namely, how IIAs can help address these serious risks, and what international law protections and remedies these agreements provide.

### Mining Law Monitor Winter 2014

- [SMCRA: It's Back in the News and That's Not Good News For Coal](#)
- [How Mining Companies Can Mitigate Risks and Protect their Investments, Part I: International Investment Agreements](#)
- [Yours, Mine, or Ours? Mitigating the Risks of Resource Nationalism](#)
- [Recent Developments in Whistleblower Retaliation Cases Under the Mine Act](#)
- [The MSHA Regulatory Agenda— an Active Year Ahead in 2014](#)

## II. How International Investment Agreements Can Help

IIAs are government-to-government agreements – such as bilateral investment treaties (BITs) and the investment chapters of free trade agreements (FTAs) – that provide legally binding, privately enforceable rules regarding one country's treatment of companies from another country and their investments. IIAs typically protect a wide range of "investments" (such as companies, equity interests, debt instruments, contract rights, intellectual property rights, and licenses and permits) and apply to government action at both the national and sub-national levels. (In other words, Canada's obligations under its IIA extend to government actions carried out at the provincial level. For example, in 2008, the provincial government in Newfoundland and Labrador expropriated certain of the assets of U.S. company AbitibiBowater, conduct for which Ottawa was legally responsible.)

With some 3,000 IIAs in existence around the world, including many concluded by developing countries with significant mining sectors, these agreements are an indispensable element of the mining company's risk management toolkit. Although they have been around for more than half a century, only in the past decade have multi-national firms in various sectors come to realize how powerful IIAs can be in addressing political and regulatory risks. As discussed in greater detail below, savvy companies are using IIAs at an increasing rate each year to protect their investments in challenging foreign markets.

### A. The Rights – Strong International Law Protections

IIAs provide internationally engaged companies with a broad range of legal protections when they invest in challenging foreign markets. As discussed below, many of these protections respond directly to the risks that mining companies most frequently face.

**National Treatment and Most-Favored-Nation Treatment.** Virtually every IIA includes obligations on governments to provide foreign investors with national treatment and most-favored-nation (MFN) treatment. This means that governments may not treat foreign companies or their investments less favorably than they treat their own companies and investments or those of a third country. For example, a government may not subject the mining subsidiary of a parent company in an IIA partner country to more stringent licensing or permitting requirements than it subjects its own mining firms or those owned by third-country investors.

**Fair and Equitable Treatment.** In addition, under almost all IIAs, governments must give fair and equitable treatment to foreign companies' investments, which generally means affording due process in judicial and administrative proceedings and protection from arbitrary or capricious government treatment. So, if a foreign gold mining company developed a mine in an IIA partner country in full accordance with the law of that country, but after two years the government were to revoke the company's permits without providing an opportunity for judicial or administrative review, the company might have a valid claim that the host government failed to provide it fair and equitable treatment.

**Full Protection and Security.** A government must also provide foreign companies' investments with full protection and security, which means that it must offer a reasonable level of police protection and law and order to ensure the investments' physical security. Thus, the government of a country experiencing civil unrest must take reasonable measures to prevent damage to a mine owned by a company headquartered in a country with which it has an IIA. Indeed, the full protection and security obligation arguably extends beyond physical protection to some notion of "legal" protection, creating duties on governments to ensure certain levels of regulatory stability and certainty.

**Expropriation.** A government may not expropriate or nationalize foreign companies' investments without paying compensation. This includes "indirect" expropriations, such as punitive tax measures that effectively deprive a company of the ability to run its business. For example, a mining company with a subsidiary in an IIA partner country that is forced to pay "fines" for infractions of various environmental regulations equal to 200 percent of its annual revenue could have a claim that such a measure is an indirect expropriation for which it is entitled to compensation.

**Transfers.** Most IIAs guarantee the right of free transfers of investment-related funds into and out of the country. This is a critical right for mining companies, who often need to move large amounts of money both into a market, to finance the establishment of an operation, and out of a market, to repatriate profits and redistribute operating capital around a global corporate structure.

**Performance Requirements.** Some IIAs provide that governments may not mandate that foreign companies or their investments meet certain types of performance requirements, such as requirements to use a certain amount of "local content," transfer technology to domestic companies, or purchase or use locally developed technology. For example, the investment provisions of the United States' FTA with Peru provide that neither country may:

impose or enforce any requirement or enforce any commitment or undertaking:

...

(b) to achieve a given level or percentage of domestic content;

(c) to purchase, use, or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory;

... [or]

(f) to transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory.

This can be an important protection for mining firms, as many governments may require the hiring of local employees or provision of know-how to state-owned mining firms as a condition of investment.

**Umbrella Clause.** Many IIAs also contain an umbrella clause, which essentially acts to import into the IIA any obligation to a foreign investor that a host government has taken on separately. In other words, a government must comply with its contractual obligations to companies of their IIA partners and their investments; a failure to do so is a breach of the IIA *as well as* of the contract. So, if a host government were to breach a term of a concession contract that it had signed with the local subsidiary of a parent mining company of an IIA partner (*see* Crowell & Moring article "Yours, *Mine*, or Ours? Mitigating the Risks of Resource Nationalism"), the parent company may be able to pursue relief under both the IIA and the contract itself. An umbrella clause could therefore allow a mining company to bring international arbitration directly against a host government for a breach of a concession agreement, as well as pursuing any separate remedy that the concession agreement provides, such as, for example, recourse to local courts.

## B. The Remedy – Binding International Arbitration

Of course, strong legal protections mean little in the absence of effective mechanisms for enforcing them. Fortunately, IIAs allow foreign companies to take governments to binding international arbitration for alleged breaches of the agreement. "Investor-State arbitration" is an extremely powerful tool for companies to enforce their IIA rights, for many reasons. First, it is direct – a company can take a government to arbitration without having to persuade its own government to espouse or otherwise support its claim. Second, it is independent – arbitrators are typically selected by both parties and hearings occur in a neutral international setting, both of which protect the company from the uncertainty of domestic court systems. Third, it is flexible – under most IIAs, the company generally has the ability to choose the arbitration institution and rules, which gives it further influence over the process. Finally, it is enforceable – awards against host governments are generally enforceable in countries that have signed international agreements relating to the enforcement of foreign arbitration awards, such as the New York Convention.

In addition, companies may be able to use one or more IIAs to seek relief in a given country. In particular, some IIAs allow companies to pursue investor-State claims against a host government even if the company invests only indirectly into the host country through its third-country investments (*i.e.*, through subsidiaries) (provided the company owns or controls both the third-country subsidiary and the host-country subsidiary that has been harmed by the government). Similarly, in some cases a parent company can initiate an investor-State claim through a subsidiary in another country that itself has an IIA with the host country (provided the third-country subsidiary owns or controls the host country subsidiary). For example, about a decade ago, American media magnate Ronald Lauder used a subsidiary that he had established in the Netherlands to pursue an IIA claim against the Czech Republic. (Many companies route their overseas investments through intermediate affiliates in the Netherlands to gain the protection of that country's significant network of investor-friendly IIAs.)

### III. How Mining Companies Should Use IIAs

IIAs can be powerful tools for mining companies to ensure that they are treated fairly, enjoy a level regulatory playing field, and can enforce their rights in difficult foreign markets. Companies need to think carefully, however, about how best to deploy these agreements in order to achieve their business objectives. In some circumstances, governments have so significantly harmed a company and shown so little inclination to modify their treatment that it may be in a company's commercial interest to pursue investor-State arbitration through to an award. Yet, in many cases, especially for mining companies that have made long-term, capital-intensive commitments to a foreign market and wish to operate there for decades, it may be in a company's business interests to use its IIAs rights and protections more subtly and indirectly. Indeed, for every investor-State case that goes through to completion, there are several instances where companies have used IIAs as leverage to negotiate with the host government and cause it to change its behavior more quickly and less expensively. For example, in the AbitibiBowater example described above, the investor was able to use the possibility of an arbitration claim under the investment provisions of the North American Free Trade Agreement as an inducement for the Harper government to settle with it.

With this in mind, mining companies would be well-served to incorporate consideration of their IIA rights into every aspect of their overseas investment activity. For example, a company needs to conduct thorough analyses of potential IIA protections before it enters a market. Similarly, if it has chosen a market that it wishes to enter, it might benefit from structuring its investment into that market through a third country that has a strong IIA with that country. (As noted, the Netherlands is frequently a popular choice.) In addition, once established in a market, that company should ensure that it fully understands the treaty rights of which it can avail itself in the event of a dispute with the host government. Then, to the extent that

differences emerge with the government over the terms of the company's investment, the company may be able to use its IIA rights as helpful leverage in seeking favorable negotiated resolution with authorities. And, finally, if the worst happens and a dispute cannot be avoided, a company can rely on the strong, binding, enforceable protections of IIAs to pursue relief directly from a host government. There is no need for a company to inform or obtain the approval of its own government; IIAs are binding international law obligations of governments to foreign investors. Under the dispute settlement provisions of IIAs described above, investors can directly pursue arbitration against governments of the countries in which they are investing.

#### IV. Conclusion

In an increasingly uncertain global business environment, IIAs can help companies ensure that they are treated fairly, enjoy a level playing field, and can enforce their rights in difficult foreign markets. IIAs should be an important element of mining companies' business strategies throughout their investment activities, from their initial evaluations of the legal and political risks of investing in various markets, to decisions about how to structure their operations, to how they navigate local regulatory and policy hurdles, and, finally, to their efforts to constructively and effectively resolve disputes with governments that do arise.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.