

## **Investors are tempted by Latin America; however they should be aware of potential risks**

In recent years Polish investors have shown a growing interest in South American markets, particularly in Brazil, Peru and Chile. A very impressive example is KGHM, a Polish mining producer which has invested in Quadra FNX Mining Ltd., a Canadian company that extracts copper in the Franke mine in Northern Chile and which is also preparing itself for the exploitation of new deposits of copper and molybdenum.

The purchase of 100% of Quadra's shares for approximately CAD 2.9 billion represents the largest Polish foreign investment to date. Another example is the investment of Selena, a globally operating manufacturer and distributor of construction chemicals, in Ponta Grossa, Brazil. Initiatives taken by the Polish Foreign Affairs Ministry are also noteworthy to mention, such as the visits last year to Chile, Peru and Brazil by some of its representatives and a group of Polish entrepreneurs seeking a fresh, more dynamic dimension to bilateral business contacts.

Prior to deciding as to whether investment should be made in South America, one should conduct an analysis of the international standards of investment protection in the target country. Investment protection and optimization potentials should be determined in a similar way that tax optimization is assessed. It is worth remembering that the level of political risk in respective South American countries, as well as the level of international legal protection guaranteed to Polish investors, varies considerably from country to country.

A prudent Polish investor should, therefore, carry out a thorough and comprehensive analysis of the relevant international treaties in existence in the target country in order to establish the level of international legal protection provided for its investment, the means by which this protection can be enforced and whether there exists a possibility for its optimization. These aspects will be examined below on the examples of Chile, Brazil and Peru.

### **Little risky Chile**

Chile is considered to have one of the lowest political risk levels in the region. No large-scale political upheavals have occurred since attempts were made to carry out radical socio-economic change during **Salvadore Allende's** presidency and, thereafter General **Augusto Pinochet's** junta. Its stability is also enhanced by the existence of numerous bilateral investment agreements ("BITs") to which Chile has signed, such as the one concluded with Poland.

The Poland-Chile BIT grants Polish investments in Chile the following primary protection:

- prohibition of unlawful expropriation (Article 6),
- the principle of fair and equitable treatment (Article 4 (1)) and
- prohibition of unreasonable and discriminatory measures (Article 3 (2)).

In addition, most-favored-nation treatment, pursuant to Article 4 (2) of the Chile-Polish BIT, allows Polish investors in pending international arbitration proceedings to invoke other more advantageous standards of investment protection granted by Chile to third state investors.

The umbrella clause incorporated into the Chile-Austria BIT (Article 2 (4)), is an example of such more advantageous standard of protection which a Polish investor can generally seek to rely upon. Such clause allows investors to claim compensation from Chile for damage arising out of a breach of an investment contract (*e.g.* a power plant construction and operation contract) entered into between an investor and the appropriate Chilean authority or any legal entity, whose actions are attributed to Chile in accordance with the principles of international public law.

The clause results in the “internationalization” of a national investment contract and opens the door for the pursuit of contractual claims together with the claims that result from the infringement of other BIT standards, before the same international tribunal, whose composition is chosen by the investor as well as Chile.

Were Chile to violate any of the above-mentioned protection standards, Polish investors would be able to pursue claims for damages at its own choice either through arbitration in accordance with UNICTRAL Rules (United Nations Commission on International Trade Law) or before Chilean local courts. The Chile-Polish BIT does in fact provide for the application of the arbitration rules applicable to the International Centre for Settlement of Investment Disputes (the “**ICSID**”). However, in view that Poland is not yet a party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Polish investors are unable to exercise this option.

It is also worth mentioning that Chile’s political stability is reflected in statistics detailing its BIT disputes with foreign investors. Currently, there are publicly known only three such disputes: the case of MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile (based on the Chile-Malaysia BIT); Victor Pey Casado and the President Allende Foundation v. Chile (based on the Chile-Spanish BIT), as well as Sociedad Anónima Eduardo Vieira v. Chile (based on the Chile-Spanish BIT).

**Brazil is in no rush to ratify the BITs**

Brazil is recognized as having a higher level of political risk than Chile. Based on the 2012 World Bank GDP ranking, Brazil has the seventh largest global economy and is known for having huge development dynamics. Brazil is distinct from its neighbors, not only by having an enormous market of approximately 200 million consumers, but also because it is not a party to any binding BIT which offers protection to foreign investors.

Brazil, has in fact, signed over a dozen BITs, however, to date none of them have been ratified by the Brazilian Parliament. In comparison to its neighbors, despite its unique foreign investment policy, Brazil has always attracted great interest from foreign investors primarily because of the size of its economy and abundant natural resources, which eclipse all other countries in the region. Thus, the Country is not short of investment, given the fact that its investment potential has been, in a sense, self-driven so far.

Public debate regarding the need to ratify BITs which Brazil has signed so far, as well as addressing the issue of entering into new ones, is rife in Brazil. These discussions are by no means due to the shortage of foreign investment in Brazil, but have a greater connection with the change in Brazil's status from a capital importing country to a country that both imports and exports. For the last 10 years Brazilians that have invested abroad have been subject to internal laws of the respective host state without being able to invoke international investment protection standards before international tribunals. This situation, no doubt, caused great concern to Petrobras, a Brazilian company which invested heavily in the gas industry in Bolivia which was nationalized in 2006 by Bolivia's President **Evo Morales** fulfilling his pre-election promise.

Polish investors considering investing in Brazil should be aware that, unless Brazil changes its foreign investment policy, their investments will not be protected by international investment law. Polish investments would, however, be protected by Brazilian law, which allow the investor to pursue claims for breach of an investment contract through the Brazilian courts for example, or before an arbitration tribunal if the other party to the contract grants proper consent for arbitration. Should Polish investors decide, after analysis of political risk, that such protection is insufficient; they may also consider the purchase of appropriate political risk insurance.

### **Peru is becoming more and more attractive**

Investors are not only attracted to Peru by its spectacular mountain landscapes and Machu Picchu, but also by its huge deposits of mineral resources: copper, silver, tin, zinc, gold and lead. Natural gas reserves and potential for hydroelectric power generation growth provide further incentive for investors. Peru has been subject to one of the largest jumps in annual GDP amongst all emerging

economies globally. This is, for example, reflected in Bloomberg's Top 20 Emerging Markets ranking of January 30, 2013 which placed Peru in fourth position (behind Thailand, South Korea and China in first place) amongst all developing countries with respect to global investment attractiveness.

Peru's level of political risk is perceived as moderate, *i.e.* greater than Brazil's. In contrast to its largest neighbor, however, Peru is a party to numerous BITs and free trade agreements ("FTAs"), which apart from having international trade provisions; also contain standards of the foreign investment protection. This allows investors to pursue their rights before international investment tribunals.

Unfortunately, this is of little significance to Polish investors as Peru is yet to sign any such agreement with Poland. Therefore, we can initially assume that Polish investors are not protected in Peru by international investment law.

Making such an assumption would, however, be a mistake. Upon deeper analysis of certain international agreements (BITs and FTAs that Peru is a party to), one can form the *prima facie* conclusion that Polish investors may, as a general rule, benefit from international investment law protection for their investments in Peru.

Therefore, an international lawyer's task will involve carrying out a comparative analysis of Peru's BITs and FTAs so that a prospective Polish investor may be advised how to optimize its operations in order to attract international legal protection for its investment. Such an analysis should focus on conditions which must be met to in order to obtain such protection, as well as the confines of such protection in view that this varies from treaty to treaty.

A treaty of high interest for Polish investors could be the Netherlands-Peru BIT. The definitions of "investor" and "investment" in the respective BIT, as well as an absence of the denial of benefit clause (Spanish: *cláusula de denegación de beneficios*), gives rise to the possible protection of Polish investments in Peru, provided that the Polish investor adopts the appropriate corporate structure for its investment vehicle.

In such a situation, a Polish investor would benefit from the same legal protection as a Dutch investor operating in Peru. Protection would include, *inter alia*: a ban on unlawful expropriation (Article 6), fair and equitable treatment (Article 3 (1)), the principle of full protection and security of the investment (Article 3 (2)), an umbrella clause with a very advantageous wording for investors (Article 3 (4)).

International investment tribunals may construe the mentioned umbrella clause contained in the Netherlands-Peru BIT broader than the umbrella clause contained in the Chile-Austria BIT which is described above. Therefore, an investor may not only consider to pursue its claims with regard to a breach of the investment contract's terms and conditions by Chile, but also the so-called unilateral obligations of Chile, including those resulting from administrative acts issued by Chilean public authorities.

In the event that Peru was to breach the Netherlands-Peru BIT, a Polish investor would generally be entitled to initiate arbitration proceedings against Peru, pursuant to the ICSID's Arbitration Rules.

### **The EU as an initiator of changes in investment law**

As may be observed, having considered the examples of Chile, Brazil and Peru, there is considerable difference between South American countries with respect to the level of international investment law protection granted to Polish investors and their optimization options. These issues should constitute an integral part of a Polish investor's due diligence before deciding to invest in a country within the region.

Polish investors also cannot overlook the fact that future international investment law will be subject to considerable change which may affect the protection of their investments in the region. Pursuant to Article 3(1)(e) and Article 207 of the Treaty on the Functioning of the European Union, in 2009 the European Union attained exclusive authority to regulate issues related to direct foreign investment.

The European Commission has extensively interpreted this authority and is of the opinion that it covers, in particular, any matters attributed to the BITs with regards EU and non-EU country relations. Thus, legal protection of Polish investors operating in South America may be subject to change depending on the EU's final course of action regarding protection of foreign investments.

Generally, it should be noted that the BITs themselves help stabilize the *status quo* of legal protection of Polish investors. In this respect, survival clauses which are found in most BITs are of particular interest. These clauses extend the protection period for investments established within the framework of the relevant BIT, following its termination by one of the contracting countries, by up to 10 or even 15 years. This provides a significant guarantee of the investor's rights.

By way of example, the BITs discussed above with respect to international investment protection of Polish investors and the potential of their optimization in South American countries, provide survival

clauses with the following duration: (i) 15 years where there is a termination of the Chile-Polish BIT, (ii) 10 years for the Austria-Chile BIT, and (iii) 15 years for the Netherlands-Peru BIT.

Regulation No. 1219/2012 of the European Parliament and Council of December 12, 2012 is an additional stabilizing mechanism. It establishes transitional arrangements for bilateral agreements between Member States and third states. The Regulation is important with respect to the international protection of Polish investors in South America inasmuch as it confirms that BITs which were signed by EU and non-EU states prior to December 1, 2009 (thus, the majority of the BITs entered into by EU states) will be binding until the moment that they are substituted by an appropriate agreement on investment protection entered into by the EU and a third country.

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