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Status of Foreign Investors under Bilateral Investment Treaties

“The Aim and Objective of Bilateral Investment Treaties Is to Provide Broad Protection for Investors and Their Investments”.¹



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This article analyzes the special regime applied to foreign investors in Ukraine under Ukraine's *Bilateral Investment Treaties for the Promotion and Reciprocal Protection of Investments* (the “BIT”). It also discusses the status of foreign investors and their investments under BIT when compared to the regime established under Ukrainian foreign investment laws.

Legal nature of BIT

It may be argued that the principal mission of a BIT is to establish a favorable, safe and effective investment regime as well as to reduce political risks for foreign investors in host countries.

A BIT may be defined as an international agreement between two contracting states (the “Contracting Parties” or individually “Contracting Party”), whereby each Contracting Party agrees to promote and encourage investment from the other Contracting Party as well as obliging each other to comply with the standards of treatment of investors and

investments from the other Contracting Party as established by the BIT.

By its legal nature as an international agreement, a BIT is governed by public international law. In order to come into effect, a signed BIT must also be duly ratified by the parties according to their law; in the case of Ukraine, a BIT must be ratified by the Ukrainian Parliament.

BIT and national laws on foreign investment

Among the acts applicable to foreign investment, should be noted: (i) the *Protection of Foreign Investment in Ukraine Act of Ukraine of 10 September 1991*, (ii) the *Investment Activity Act of Ukraine of 18 September 1991*, (the “*Investment Activity Act*”), and (iii) the *Regime of Foreign Investment Act of Ukraine of 19 March 1996* (the “*Foreign Investment Act*”).

According to the *Constitution of Ukraine*, after the ratification by the Parliament of Ukraine, a BIT is an integral part of Ukrainian national legislation. However, in the event of any discrepancies between Ukrainian legislation and the BIT, the latter has priority. Nevertheless, it should be noted, for example, that the Ukraine-UK BIT (and several other BIT as well) provides that if national legislation of the Contracting Parties provide for more favorable treatment of investments from the other Contracting Party than as provided in the BIT, then such more favorable national law provisions should prevail. Thus, it may be argued that foreign investment covered by the Ukraine-UK BIT may not be nationalized in Ukraine, regardless of the fact that the right of the host state to nationalize foreign investment from the other Contracting Party (in the exception-

al intences discussed below) is provided for in this BIT. On the basis of Article 9 of the *Foreign Investment Act*, which provides that “*foreign investment in Ukraine shall not be nationalized*” and on the discrepancies application rule as established in the Ukraine-UK BIT, it can be concluded that Ukraine waived its right to nationalize UK investments in Ukraine.

Often, the provisions of a BIT refer to national laws, in particular, to administrative or procedural rules applicable to foreign investment. These references, *inter alia*, relate to: (1) the need to obtain permission for certain activities – the Ukraine-Poland BIT provides that in the event of a Contracting Party permitting foreign investment on its territory all the necessary licenses related to such investment shall be issued according to the national legislation of the host state; (2) work permits for foreigners – under the Ukraine-Turkey BIT, companies with Turkish investment in Ukraine have the right to hire management and technical personnel in Ukraine according to applicable Ukrainian law; and, (3) under the Ukraine-US BIT, this BIT shall not derogate from laws and regulations, administrative practices or procedures, or administrative or adjudicatory decisions of either Contracting Party and not preclude either party from prescribing special formalities in connection with the establishment of investments, though such formalities shall not impair the substance of any of the rights set forth in the BIT.

Investments covered by BIT

It should be emphasized that the vast majority of the BIT broadly define protected investments, usually stipulating that an investment shall include:

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(1) movable and immovable property as well as any other rights *in rem*, such as mortgages, pledges, liens or servitudes;

(2) shares and other types of interests in companies and joint ventures;

(3) claims to money, to other assets or to any performance having an economic value;

(4) intellectual property rights, such as copyright, patents, trade marks, industrial design or models, good will, know-how, etc.; and,

(5) rights and concessions under public law or under contract, including rights to explore and exploit natural resources as well as other rights granted by law, license and/or by the decision of a state authority.

Who are the investors under BIT?

Definition of “investors” (or in some BIT, “nationals”) is set out in each BIT and usually includes: (1) a person (individual) whose nationality (citizenship) is that of one of the Contracting Parties to a BIT, and (2) a legal entity (including company, corporation and other type of organization) constituted under the law of one of the Contracting Parties. It should be borne in mind that for the latter type of an investor, a BIT may introduce different conditions that either limit or expand the potential legal entities qualifying as investors under a BIT. Thus, for example, the Ukraine-Switzerland BIT provides that a legal entity that is not established under the law of the Contracting Party, but is effectively controlled by individuals or companies which are nationals of that Contracting Party should also be regarded as an investor under this BIT.

The Ukraine-US BIT, on the other hand, is an example where the Contracting Parties reserve the right, in particular, not to grant the treatment as established under the BIT to some investors. Article I (2) of the Ukraine-US BIT stipulates that “each party reserves the right to deny to any company the advantages of this Treaty [Ukraine-US BIT] if nationals of any third country control such company and, in the case of a company of the other Party, that company has no substantial business activities in the territory of the other Party or is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations”.

In addition, the Ukraine-Turkey BIT also provides that in order to be regarded as an investor, a company must not only be established under the laws of the Contracting Party, but its management must also be conducted on the territory of this Contracting Party. In this case it is interesting to refer to the ICSID Decision on Jurisdiction in *Tokios Tokeles v. Ukraine*, where one of the principal legal issues with which Tribunal was dealing was whether the company (Tokios Tokeles), although established under the laws of Lithuania but effectively controlled and owned by Ukrainian nationals, may be treated under the Ukraine-Lithuania BIT as an investor. The tribunal notes in its decision: “[BIT] confirm that state parties are capable of excluding from the scope of the [BIT] entities of the other party that are controlled by nationals of third countries or by nationals of the host country. By contrast, the Ukraine-Lithuania BIT includes no such “denial benefits” provision with respect to entities controlled by third-country nationals or by nationals of the denying party. ...the only relevant consideration is whether the Claimant is established under the laws of Lithuania. We find that it is. Thus, the Claimant is an investor of Lithuania under Article 1(2)(b) of the [Ukraine-Lithuania] BIT”.²

Investor’s rights under BIT

It should be stressed that not all BIT provide the same rights for investors in host countries; however, the most prevalent rights provided by BIT for investors include *inter alia* the following:

(1) Most Favoured Nation (“MFN”) treatment: According to the MFN principle, one Contracting Party shall in its territory grant to investors of the other Contracting Party treatment that is not less favorable than that which it grants to investors of any third state. However, states often also provide for an exclusion from the MFN treatment, in particular, in instances when one state is granting special advantages to nationals of any third state by virtue of other bilateral or multilateral agreements establishing customs unions, economic unions, monetary unions, etc. In this situation the Contracting Party under a BIT is not obliged to grant such advantages to investors of the other Contracting Party;

(2) National Treatment: Foreign investors should enjoy treatment no less favorable than the treatment granted by the host state to its own investors;

(3) Full Protection and Security: As observed by various foreign academics and international arbitration practice, this principle is understood as the host state taking reasonable measures to protect the investor. The state is not an insurer or a guarantor of the investor’s security and it bears neither an absolute liability nor strict liability for the investor and its investment;

(4) Protection Against Expropriation, Nationalization:

According to the conditions established by most BIT, expropriation of foreign investment by a host state may be possible, and would not be considered a violation of the BIT if such expropriation is conducted (a) for a public purpose, (b) under due process of law, (c) in a non-discriminatory manner, and (d) against prompt, adequate (fair) and effective compensation;

(5) Repatriation of Investment: This provision guarantees foreign investors the right to transfer the investment and returns (including profits, interest, dividends, royalties, repayment of loans etc.) to the investment in a freely convertible currency, without undue restrictions or delay. Notwithstanding this provision, a state may maintain national laws and regulations concerning the investors’ reporting obligation regarding the transfers and imposition of certain taxes on these funds.

Conclusion

The BIT, in addition to Ukrainian foreign investment legislation and multilateral treaties to which Ukraine is a party, create for foreign investors a legal framework aiming not only to protect investor rights, but also to establish favorable and stable conditions for the development of their businesses in Ukraine. Currently, Ukraine is a party to over 60 BIT, therefore, investors should not neglect to study and apply the BIT between their home country and Ukraine and use all the benefits of the BIT when necessary. ■

¹ The ICSID Decision on Jurisdiction in *Tokios Tokeles v. Ukraine* case No.ARB/02/18, dated 29 April 2004, paragraph 85.

² *Ibid*, paragraph 36 and 39.