New Arbitral Ruling in Yukos Case Exposes Possible Gaps in Bilateral Investment Treaty (BIT) Coverage for Managed Investment Funds

Important Lessons for Funds Investing in Emerging Markets or Volatile Countries

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Investors in emerging markets or volatile foreign jurisdictions are increasingly focusing on the legal protections that may be available to them under applicable bilateral investment treaties (BITs) or free trade agreements (FTAs), should their investments be subjected to expropriation or other hostile host government action. BIT or FTA protections typically feature the right to pursue investor/state arbitration claims before an international forum such as the International Centre for Settlement of Investment Disputes (ICSID) in Washington, D.C., plus the right to claim damages equal to the market value of an expropriated investment.

The need for effective BIT/FTA protection has been felt more keenly in light of recent nationalizations and asset seizures in parts of Latin America, Africa and the former Soviet Bloc. Only this month, for instance, the President of Venezuela announced that "land is for the people" and that certain real estate within Venezuela is now liable to be seized. This continues a wave of "nationalizations" in the Venezuelan oil, electricity, telecommunications and infrastructure sectors, as well as similar programs in Bolivia.

A recent arbitral decision rendered under the Spain-Russia BIT has shed light on a possible limitation on investment treaty coverage in the case of managed funds. In *Renta 4 S.V.S.A. v. Russian Federation* (SCC, Mar. 29, 2009), seven Spanish investors claimed damages against Russia following the alleged governmental takeover of the assets of Yukos Oil Company in 2004. Each of these investors owned American Depositary Receipts (ADRs), issued by New York banks and backed by Yukos stock, whose value, they claimed, had been destroyed by the government takeover. They sought damages on the theory that this amounted to an "expropriation" of their "investment" in Yukos, in violation of the Spain-Russia BIT. In response, the Russian government challenged the Tribunal's jurisdiction.

In its unanimous jurisdictional ruling, the arbitral Tribunal refused to dismiss the claims of four Spanish corporations that had held Yukos ADRs. The Tribunal held that ADRs were a protected form of "investment" under the Spain-Russia BIT (which was not just limited to ordinary shareholders).

At the same time, however, the arbitral Tribunal dismissed the claims of two managed funds, Emergentes and Eurofundo, as well as those of a fund custodian, Renta 4 S.V.S.A, on the grounds that they were not "investors" as defined by the Spain-Russia BIT. Under that BIT, "investors" included natural persons ("*persona fisica*") or corporate bodies ("*persona juridica*"). This definition did not extend to "collective investment funds," in which custodianship, ownership and management of assets were divided among different entities.

Owing to their "tripartite" legal structure, these collective investment funds were not "corporate bodies" under Spanish law, and therefore fell outside the scope of the Spain-Russia BIT.

The *Renta* Tribunal acknowledged that the denial of BIT coverage to a managed fund was "formalistic," but added that its conclusion was "unavoidable" given the "text" of the Spain-Russia BIT, which applied only to "corporate bodies" and individuals.

The *Renta* holding is potentially significant for all managed funds with investments in emerging markets or other countries with high political volatility. Although it is not precedent in the conventional common law sense, it can and likely will be cited in future arbitrations for its persuasive value. Sovereign states can therefore be expected to cite *Renta* in future disputes as a basis for denying BIT/FTA protection to unincorporated funds and similar investment vehicles organized along legal forms not recognized for protection under the relevant BIT or FTA. The outcome of any future challenge will depend on many factors, including the specific wording of the BIT or FTA—not all of,which are drafted the same way as the Spain-Russia BIT. Some BITs and FTAs, for example, contain a broader definition of "investor" by including "trusts," "firms," and/or "associations."

For now, the *Renta* case warrants the immediate attention of fund managers and trustees who wish to maximize their BIT/FTA protection and arbitral rights for the assets under their control. It may prompt a review of existing investment structures to ascertain if they can or should be modified to maximize BIT/FTA protection (*e.g.*, where appropriate and possible, by interposing holding companies between the fund and its foreign assets that might qualify as an "investor" under an applicable BIT/FTA). Such an exercise demands careful attention to the terms of any potentially applicable BIT/FTA, as well as to the tax and other legal consequences of any restructuring.

Maximizing BIT/FTA protection will not physically stop a hostile and determined government from engaging in expropriation, in breach of its treaty commitments. Nevertheless, BITs and FTAs do provide arbitral forums in which to seek compensation if such events occur. In some cases, the existence of potential BIT or FTA arbitral remedies may actually deter governmental seizures in the first place.

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