International
Comparative
Legal Guides

Practical cross-border insights into investor-state arbitration law

Investor-State Arbitration 2022

Fourth Edition

Contributing Editor:
Tafadzwa Pasipanodya
Foley Hoag LLP

CDR
Commercial Dispute Resolution

EFILA
European Federation for Investment Law and Arbitration

ICLG.com

Expert Analysis Chapters

Q&A Chapters

Collecting Investor-State Awards

Kobre & Kim

Andrew Stafford QC

On 25th November 1959, Germany and Pakistan signed the first bilateral investment treaty (BIT). Sixty years on, there are currently 2,896 such treaties, of which 2,339 are in force. The most recent BIT is between two BRIC states – India and Brazil. BITs have facilitated the export of capital into some of the most capital-starved economies in the world, permitting the development of infrastructure projects and the exploitation of natural resources by promising to foreign investors a more or less level playing field, with legal recourse in the event that the promise is broken.

When the promise is broken, International Centre for Settlement of Investment Disputes (ICSID), United Nations Commission on International Trade Law (UNCITRAL), London Court of International Arbitration (LCIA) arbitration procedures (amongst others) are triggered. As a consequence of the numerous BITs and the disputes to which they have given rise, a highly specialised sub-set of arbitration advocates has built a formidable professional expertise, constructing a large body of jurisprudence and honing its skills to the specific context of litigating investor-state disputes. To further refine their specialised skills, these advocates have often set up boutique firms which focus almost exclusively on investor-state disputes.

Collecting an award is what makes meaningful to a victim-investor the right of legal recourse which a BIT offers. The proliferation of BIT awards has in fact given rise to numerous, long-running and complicated collection sagas, usually involving multijurisdictional efforts. The collection efforts demand a specialist skill-set different from that required to secure the award itself. Our experience of acting in monetisation campaigns is that we need to combine our specialist experience in collecting an award with the separate specialised skills of the arbitration advocates.

This chapter concentrates on the challenges facing an investor seeking to monetise an award made against a sovereign state.

Sometimes, the awards secured by arbitration specialists for their investor clients are so large as to represent a material percentage of a state's GDP. A recent example is the $6 billion award made against the Federal Republic of Nigeria which, with accumulated interest, now tots up to an eye-watering $10 billion. Large awards can represent not only a financial problem for the debtor-state, but also a political problem. Even were there to be a commercial willingness to pay part or all of the award, if the political environment is hostile, the decision-makers in the government would have strong incentives not to do so. The decision-maker will look to see what tools are to hand to prevent the need for payment, or at least delay payment until it has become a problem for his successor in ministerial office.

The challenges to collection are more numerous and more complicated than those confronting an award-creditor seeking to monetise an award against a commercial counterparty. In the latter case, the playbook is pretty well known. Identify assets and revenue streams. Secure the recognition of the award in relevant jurisdictions. Garnish debts owed to the debtor. Obtain freezing orders if the debtor appears to be playing fast and loose with its assets. Use insolvency tools to take over the levers of power, and to hold the previous management personally to account for the enforcement-evading defalcations. There are plenty of options to keep the collection efforts on an offensive footing: and very few counter-offensive strategies available to the debtor.

By contrast, a debtor-state has plenty of opportunities to slow down or even prevent effective monetisation. Some of these opportunities are legal barriers to enforcement, and some comprise powers specific to sovereign status, re-purposed from their original objective, and turned into debt-evasion techniques.

If we run through some parts of the commercial award monetisation playbook, it can readily be seen that some of those plays are – in theory – equally valid in the context of collecting on an investor-state award. But there is a big difference between theory and practice.

I start by looking at garnishment and asset seizure. An award-creditor can pursue garnishee proceedings against a third party which owes money to a state. However, even the simple garnishee process can pose tricky problems when the award debtor is a sovereign state. First, at a factual level, although many sovereign states dabble in the commercial exploitation of, say, natural resources which thereby generate third-party debts, this activity is more often than not undertaken by a state-owned entity of which the sovereign state is simply the sole shareholder. Money owed by a commercial debtor to the state-owned enterprise (SOE) is obviously not the same as money owed to the state and, in order to progress a garnishee campaign, it may then become necessary for the investor to grasp what can prove to be a real stinging-nettle – the alter ego doctrine.

The jurisprudence across numerous jurisdictions demonstrates that proving an SOE to be the alter ego of a debtor-state is a tough gig. Ordinary principles of separate corporate personality will likely apply. The limited exceptions permitting the corporate veil to be drawn aside are not frequently applicable. Tough, but not impossible, as two recent cases demonstrate. In the first, a French court held that the Libyan Investment Authority was an alter ego for Libya. In the second, Esso and Shell were able to secure a ruling from a US court that a Nigerian SOE was an alter ego of the Nigerian state.

Sometimes, the evidence shows that the debtor-state has actually undermined the stand-alone status of its SOE by political meddling. Some governments, having gone to the trouble of setting up stand-alone SOE structures, seemingly cannot resist the temptation to pack the board of the SOE with government ministers and senior civil servants, or dip into the money held by the SOE. In our experience, a change of government or regime is often the trigger for this kind of board-packing, as the incoming government grabs hold of as many levers of financial power it can, without pausing to consider the knock-on effects. The evidence-gathering needed to construct a viable alter ego case theory will obviously involve digging into public source materials, much of which will no doubt be online, but often much of it is only accessible through boots on the ground within the territory of the debtor-state. The accuracy with which material is identified and the care with which it is then obtained involves highly acute and sensitive project management.

Once the materials have been gathered, and a conclusion has been reached that the alter ego case theory can be deployed against a debtor-state's SOE, the next step is to pick your target and strike.

But where? A state most probably will have many of its assets and revenue streams within its own territories, but litigating in the courts of the debtor-state is often not an attractive option. In litigation currently brought in the United States against the Federal Republic of Nigeria, Esso and Shell have filed evidence (including expert evidence) which asserts that the Nigerian courts very rarely made a decision against the state or an SOE. Although this evidence has been disputed, the point remains that in some countries, separation of powers between legislature, executive and judiciary can be doubted. An award-creditor has to think very carefully before seeking to use the courts of the debtor-state as its means of collecting on the award. Oftentimes, the better option is to look at collection opportunities elsewhere.

In the case of oil- or gas-exporting debtor-states, this will involve looking at bills of lading to understand whether or not the purchaser of the oil/gas pays upfront (in which case there is no debt to garnish). If, instead of garnishment, what is planned is to seize a particular cargo of oil or gas, shipping routes need to scrutinised to identify where and when to strike.

This is as much a matter of law as of fact. Into which jurisdiction(s) does the ship carrying the cargo enter? Does that jurisdiction have an easy or difficult recognition regime? Is it a jurisdiction which accepts the alter ego doctrine as a valid way of enforcing against a state? Do the courts of that jurisdiction grant pre-judgment attachments so that the cargo is impounded pending determination of the recognition and alter ego issues? Do the courts allow for discovery against a debtor-state so that all the materials relevant to the alter ego issue are available to the award-creditor and the court? Do the courts demand the award-creditor to post a bond as part of the pre-judgment attachment and, if so, will the bond be small or prohibitively large?

One example of successfully managing such a targeted campaign relates to the *PDVSA* case.[1] The award-creditor held an award against a Venezuelan SOE which exported oil from Venezuela. Investigations revealed that ships carrying export oil from Venezuela docked in Caracas in the Dutch Antilles to decant small cargoes from numerous small ships into fewer larger ships, then continued the voyage to the final destination. The law of the Dutch Antilles permitted pre-judgment attachment. One small, low-value cargo was duly seized. The effect was disproportionate to the value of the cargo seized. PDVSA immediately recalled its entire fleet of small ships to their home ports on the basis that, if one seizure could be done, why not many? The award-creditor's show of legal strength in the form of the pre-judgment attachment triggered the SOE to settle, so that the export of oil from Venezuela could resume.

Mapping assets is an obvious feature of any collection campaign against a debtor-state. Only by mapping is it possible to sift through the various potential targets, identify the collection opportunities, the legal characteristics of relevant jurisdictions, and analyse the chances of success. The most prominent features of such mapping will be property and banking arrangements outside the territory of the debtor-state.

…Which brings me to the *Chevron–Ecuador* case. A good military strategy is to sneak up on your adversary and, unseen, park your tanks on his lawn. This was successfully done by my firm in one case in which the award-creditor (Chevron) harnessed US post-award discovery, and combined it with gagging orders. Banks were required to provide to Chevron documents relating to Ecuador's finances. The courts ordered the banks not to tip off Ecuador that the documents had been provided. Once all of the information had been collated, Chevron laid out to the Ecuadorian government the scale of its knowledge. Ecuador folded, and paid 100% of the award, leading to a Presidential broadcast in which it was explained to the people of Ecuador that there was no alternative because Chevron knew everything about Ecuador's assets. The recidivist bank-robber Willie Sutton, when asked why he robbed banks, famously answered: "*[B]ecause that's where they keep the money*." Chevron's successful strategy demonstrates the continued usefulness of Willie Sutton's one-page playbook.

With banking and other state-owned assets, there is a particular feature of the monetisation landscape which significantly differentiates debtor-state collections from monetising against a commercial award-debtor – state immunity. For entirely proper and laudable reasons, comity of nations dictates that the property and assets of a sovereign state are generally immune from execution. Since all sovereign states are equally sovereign, one state (and the courts of one state) cannot force another state to submit to a judicial order. The problem for an award-creditor is that this immunity positively incentivises the debtor-state to cock a snook at the award, and simply refuse to pay what is due. "*Catch me if you can*" may not be an especially dignified posture for a state to adopt, but it can be highly effective. And very useful if the award is a political hot potato. If a debtor-state can play this game for long enough, exasperation or financial exhaustion may prompt the award-creditor to settle for a significant discount.

Targeting a debtor-state's banking facilities might naturally fit into a garnishee strategy because the basic relationship of customer-banker is debtor-creditor. Typically, however, the relationship is more complicated because many states entrust asset management to banks in one of the world financial centres – New York, London, Hong Kong and so forth. So, the next question becomes – whose money is it? That of the debtor-state, an SOE (such as a sovereign wealth fund) or that of the debtor-state's central bank? The position under the law of state immunity is that a state's central bank is given special protection, so this question is pretty fundamental to an effective strategy.

Get through that barrier (and it <u>can</u> be done by careful analysis and targeting), and the next obstacle to clear is the need to collect evidence which will support the proposition that the asset, property or money is in commercial use. Although the law of each jurisdiction has its own important subtleties, the fundamental rule is that only assets which are in commercial use are outside the scope of state immunity.

However, sometimes an award-creditor will choose to cut through legal barriers, the evasions of a debtor-state and the protections of state immunity by putting on a show of muscle to send a message to the debtor-state that the award-creditor will never give up. The most famous example of this is the celebrated case in which an award-creditor seized an Argentinian warship. In due course, the seizure was reversed (apparently a warship is not something which is in commercial use – who knew?). Despite the discharge of seizure order, the award-creditor had sent a very powerful message to the debtor-state – "*Yeah? You and whose navy?*"

Pausing for a moment, one might rightly conclude that these debtor-state evasions would not be possible in the case of a commercial debtor. You would get a worldwide freezing injunction, or put the debtor into insolvency. But you cannot put a sovereign state into insolvency. And under many systems of law, you cannot get a freezing injunction against a state because an injunction involves compelling one state to obey the commands of another state. Creativity and persistence are definitely required to bring the debtor-state to the table.

One of the most striking differences between collecting a commercial debt and a debt owed by a state relates to the capacity which a state has to fight back against collection efforts. This can be seen clearly in the context of recognition proceedings where facially identical rules operate very differently when seeking recognition of an award rendered against a sovereign state.

As with a commercial arbitration award, the investor seeking to enforce an award against a debtor-state will need to secure recognition of its award either under domestic legislation or under the New York Convention, except in the case of an award made under ICSID arbitration procedures (under which the award is automatically recognised). Although most rule-of-law jurisdictions are "arbitration friendly", and are enthusiastic proponents of finality and certainty, one of the constant features of legal regimes is a fraud exception – your award may be set aside, or recognition of your award may be refused if the award is shown to have been procured by fraud. In some jurisdictions, this is part of domestic legislation, and it certainly falls within the ambit of the "public policy" exception to recognition enshrined within the New York convention.

The fraud exception to recognition *operates* differently when the award arises from a BIT arbitration award against a sovereign state. In both commercial and investor-state cases, evidence of fraud can be hard to find, but the state's capacity to investigate is much greater than that of a commercial award creditor. The state also has the power to take counter-measures against the award-creditor (and its principals) in ways which are not available to an ordinary commercial award-debtor.

Compare the investigatory tools which each can bring to bear. A commercial award-debtor might be able to investigate by informal means, and might be able to take discovery from third parties, but the former is something of a blunt instrument, and the latter is invariably highly adversarial and often runs the risk of tipping off the award-debtor. By contrast, under its own criminal justice system and through its international cooperation treaties, a debtor-state is highly likely to have wide and strong investigatory powers. These powers are aimed at the detection of crime and the enforcement of criminal penalties against wrongdoers. Using its domestic powers, the state can search and seize documents. It can arrest suspected fraudsters and those suspected of aiding and abetting their activities, or it can seek their extradition from abroad if there are relevant treaties. It can put the fraudsters and their accomplices on trial and, on conviction, can exercise powers of criminal forfeiture. It can invoke public policy to place a company into liquidation on public policy grounds. It can trigger Mutual Legal Assistance Treaties. It can seek and obtain Interpol Red Notices. A commercial debtor has none of these powers.

With these domestic and treaty-based powers, a debtor-state intent on resisting collection efforts can weaponise criminal investigatory and prosecutorial powers against the creditor whom the state suspects is guilty of fraud. One might argue that, if fraud is suspected, what is wrong with a state making use of these powers? Nothing, in the genuine case of fraud. But if the award is large, and if payment of the award would cause political trouble, the temptation to pursue "suspected fraud" can lead to over-zealous investigations and prosecutions.

When should an award-creditor start thinking about or preparing an enforcement strategy to maximise the chances of monetisation? You could argue that a potential investor should actually start thinking about this issue before it even makes its inward investment – after all, if the existence of the BIT encourages inward investment, surely part of that investment decision should be to consider whether, if my investment is, for example, expropriated and I have to go to arbitration, do I trust the expropriators to pay up meekly when I eventually get an award? As Machiavelli counselled – "*Put not your trust in Princes*".

Counsel of pre-investment perfection aside, it is highly desirable to prepare collection strategies before the award is rendered. The pressure on the debtor-state of an unfavourable award followed immediately by a well-aimed collection effort can induce decision-makers in the debtor-state to find a quick way out, especially if the decision-maker has to face domestic political music over the arbitration defeat. Specialist investor-state advocates working alongside specialist sovereign debt collection lawyers is a pretty formidable combination.

BITs are amongst the engines of globalisation, driving capital to where it can do good, and at the same time provide to the investor a satisfactory return on investment. Recourse to BIT arbitration is one of the ways in which the inherent investment risks can be mitigated. But without the ability to *collect* on a BIT award, an investor's ability to invoke the protection of a BIT yields only an official piece of paper declaring the investor to be a victim. You can't take that to the bank.

Endnote

1. Note that this is not an alter ego case. And full disclosure – Kobre & Kim was the firm which executed this strategy.

Andrew Stafford QC is an English barrister and Queen's Counsel who represents corporations, hedge funds and high-net-worth individuals in complex, high-value litigations spanning multiple jurisdictions and which involve significant cross-border elements. He has particular experience in international judgment enforcement, developing and executing strategies designed to secure effective collection of awards and judgments, including relating to enforcement against sovereign judgment debtors. In the area of financial services and products, Mr. Stafford QC handles swaps litigation, including matters of currency fixing related to Libor, Euribor and foreign exchange markets.

A highly regarded appellate advocate and trial lawyer, Mr. Stafford QC appears in the Supreme Court of the United Kingdom and acts in international arbitrations on a range of matters, including financial derivatives, insurance and international commercial fraud. He has been cited by industry publications as "*a really good lateral thinker*" and "*a great tactician*" with "*fantastic courtroom demeanor*".

Kobre & Kim
Tower 42
25 Old Broad Street
London EC2N 1HQ
United Kingdom

Tel: +44 20 3301 5709
Email: andrew.stafford@kobrekim.com
URL: www.kobrekim.com

Founded in 2003, Kobre & Kim is a global law firm focused exclusively on international disputes and investigations, often involving allegations of fraud or misconduct. Kobre & Kim has developed a reputation as a go-to firm for complex cross-border dispute resolution. Founded by two former U.S. Department of Justice prosecutors, the firm has organically grown to more than 300 employees who work out of offices in Asia, Europe, the Middle East, the U.S., South America, and the Caribbean.

The firm generally avoids repeat client relationships and is therefore "conflict-free". As such, it maintains a diverse client base – including Fortune 500 companies, hedge funds, private equity firms, top-level corporate executives, and foreign citizens – and remains unencumbered by long-term client relationships that so often stifle the workflow of other law firms, and instead is often engaged by other law firms to act as special litigation counsel to handle complex disputes on behalf of their clients.

www.kobrekim.com

ICLG.com

Current titles in the ICLG series

Alternative Investment Funds
Anti-Money Laundering
Aviation Finance & Leasing
Aviation Law
Business Crime
Cartels & Leniency
Class & Group Actions
Competition Litigation
Construction & Engineering Law
Consumer Protection
Copyright
Corporate Governance
Corporate Immigration
Corporate Investigations
Corporate Tax
Cybersecurity
Data Protection
Derivatives
Designs
Digital Business
Digital Health
Drug & Medical Device Litigation
Employment & Labour Law
Enforcement of Foreign Judgments
Environment & Climate Change Law
Environmental, Social & Governance Law
Family Law
Fintech
Foreign Direct Investment Regimes
Franchise
Gambling
Insurance & Reinsurance
International Arbitration
Investor-State Arbitration
Lending & Secured Finance
Litigation & Dispute Resolution
Merger Control
Mergers & Acquisitions
Mining Law
Oil & Gas Regulation
Patents
Pharmaceutical Advertising
Private Client
Private Equity
Product Liability
Project Finance
Public Investment Funds
Public Procurement
Real Estate
Renewable Energy
Restructuring & Insolvency
Sanctions
Securitisation
Shipping Law
Technology Sourcing
Telecoms, Media & Internet
Trade Marks
Vertical Agreements and Dominant Firms

The International Comparative Legal Guides are published by: glg global legal group