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Simon Wolfe

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Recent Development (Non-Arbitration): When Winning before a Tribunal Isn't Enough: Why Protecting One's Social License is Necessary in Emerging Markets

by Simon Wolfe, LL.M.

(ICAL Class of 2011-2012)

I. Introduction

In international commercial and investment arbitration, it is essential that foreign investors adopt a wider risk management strategy that leverages and goes beyond black letter legal advice and looks beyond tribunals and courts when resolving disputes. This requires an acceptance that foreign investment is fundamentally political, and so therefore are the disputes that arise from those investments.

Russia's invasion of Ukraine in February 2022 is a stark reminder of this and has destroyed the myth that corporates can remain neutral to politics. Much business with Russia is now prevented by sanctions – and others (including BP (see below)) are withdrawing by self-sanctioning dealing with the country. Foreign investment is political, and disputes from those investments are as well.

Disputes in emerging and frontier markets lay bare a truism many arbitration and litigation practitioners understand: the dispute in and of itself is often merely the tip of the iceberg. The legal process, which rightly deals with the evidence and laws before it to decide the dispute, may not address the underlying cause of a relationship breakdown, or provide a permanent solution. This phenomenon is clearer to witness in emerging and frontier markets largely due to the closer interaction of business, law and politics. A contractual dispute between a foreign investor and a host state for delivery of road infrastructure is rarely just about the failure to lay the asphalt or make timely payments; it has resulted because of a deeper break in trust; a loss of social license to operate. If this is the case, parties to disputes (and their lawyers) must think beyond gathering evidence and producing strong legal arguments to obtain a favourable ruling before a tribunal. They must go deeper to understand where the trust broke down and how the rupture can be addressed. In doing so they will understand the true causes of a dispute which may either help with its swifter resolution or enable a continued commercial relationship between the parties.

Equally, even if victory is achieved in a legal forum, this does not guarantee a commercially satisfying result for the winner – all of the causes of the dispute (e.g. toxic politics, community opposition, business & human rights issues) can resurface to prevent enforcement or destroy any long-term prospects of a continued investor-state relationship.

The challenge to foreign investors is not limited to winning and enforcing arbitral awards. In many emerging markets, disputes may be played out simultaneously in domestic courts and international tribunals while the real battles take place in the political arena and comprise murkier tactics that a strictly legal approach may be insufficient on its own to tackle. The following paragraphs highlight cases in India, Russia, and

Tanzania which illustrate the need for a wider strategy in dispute resolution.

Investor-state disputes should be viewed as inherently political. Charles Brower writes, "Starting with the political character of investment treaty disputes, one should pause to observe that claims under investment treaties almost always involve challenges to the public acts, and often to the public regulatory acts, of host states. In addition, they tend to cluster around politically sensitive topics... In other words, investment treaty disputes often occur in highly politicised contexts." (Charles H. Brower II, *Politics, Reason, and the Trajectory of Investor-State Dispute Settlement*, 49 Loyola University Chicago Law Journal, 271, 272-277, (2017))

In effect, experience shows that legal action is a protective tool and a useful tactic, but not always a successful business strategy. If investor-state disputes and the reasons they occur are inherently political, it follows that foreign investors must approach each step of their investments with the politics and public opinion of the host (and sometimes also home country) in mind.

As most practitioners will be intimately aware of, winning an arbitral award – especially against a state – is just the start of what could prove to be a long and potentially fruitless battle to obtain pecuniary relief. While it is difficult to gauge the extent to which arbitral awards are properly enforced due to their inherent confidentiality (Steven Finizio, Danielle Morris and Katherine Drage, *Enforcing arbitral awards in Sub-Saharan Africa--Part 2*, 1 Lexis PSL Arbitration, 1 (2015)), practical problems relating to enforcement are a serious issue. This may be because domestic courts prove unwilling to enforce an arbitral award for political reasons, or a state party claims sovereign immunity and refuses to accept the arbitral award, among other factors.

II. Enforcement battles with India

In India, for example, multiple cases were brought to international tribunals in connection with the passage of a 2012 law which retroactively amended the country's tax laws. The most controversial of these cases is *Cairn Energy Plc and Cairn UK Holdings Limited v The Republic of India* (http://arbitrationblog.kluwerarbitration.com/2021/07/02/the-cairn-energy-v-india-saga-a-case-of-retrospective-tax-and-sovereign-resistance-against-investor-state-awards/, last accessed 21 Oct 2021). In this case Cairn, a UK-based entity, was hit with a USD 1.6 billion tax liability relating to a transaction in 2006. When Cairn challenged the tax bill under the UK-India BIT, India seized shares held by Cairn in another entity among other punitive measures (http://arbitrationblog.kluwerarbitration.com/2021/07/02/the-cairn-energy-v-india-saga-a-case-of-retrospective-tax-and-sovereign-resistance-against-investor-state-awards/, last accessed on 21 October 2021). When the international arbitral tribunal ruled in Cairn's favour with a USD 1.2 billion judgement, India reportedly ordered state-run banks to withdraw cash held overseas in an effort to prevent enforcement of the arbitral award while it challenged the decision at the Permanent Court of Arbitration at the Hague (https://www.reuters.com/world/india/exclusive-india-asks-state-banks-withdraw-cash-held-abroad-over-cairn-dispute-2021-05-06/, last accessed on 21 October 2021).

The Indian government argued that the case was a matter of public policy. While Cairn pursued Indian state-owned assets across the globe – from attempting to seize Air India's planes (https://www.bbc.com/news/business-57742080, last accessed on 17 January 2021) to a successful freezing of Indian state-owned property assets in Paris (https://www.reuters.com/world/india/cairn-wins-freeze-indias-state-owned-assets-paris-recover-tax-award-2021-07-08/, last accessed on 17 January 2021) – India attempted to turn the dispute away from the merits of the case, focusing instead on public perceptions and policy relating to global tax avoidance. A 23 May 2021 statement from the Ministry of Finance declared that "the award improperly ratifies Cairn's scheme to achieve Double Non-Taxation, which was designed to avoid paying taxes anywhere in the world, a significant public policy concern for governments worldwide." (https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1721039, last accessed on 21 October 2021).

After years of bitter dispute between Cairn and the Indian government, Cairn's efforts to seize Indian government property globally and its relentless media push appears to have won the day, with New Delhi announcing that it would rescind the controversial tax law and refund Cairn as well as other affected companies, which Cairn ultimately accepted. (https://www.business-standard.com/article/companies/cairn-accepts-1-bn-refund-offer-to-drop-cases-against-india-ceo-121090700667_1.html, last accessed on 17 January 2021). The Indian government, rather than admitting legal defeat, appears to have caved under the "increasingly embarrassing" public spat which has damaged investor confidence.

As the Cairn case clearly demonstrates, public pressure is often an essential step to reach a settlement or satisfactory resolution of an investor-state dispute. It was not the prospect of India losing its properties in Paris or the spectre of Air India jets being taken at airports around the world that forced New Delhi to buckle under pressure; rather, it was the considerable damage to India's image as a place safe for foreign investment that ultimately forced the issue. Furthermore, it greatly helped that India under Narendra Modi and the BJP prides itself as being business friendly: ironically, while in opposition in 2012 the BJP had called the retrospective tax law "tax terrorism." (https://www.thehindu.com/opinion/editorial/rewind-to-fast-forward-the-hindu-editorial-on-retrospective-tax/article35776104.ece) last accessed on 17 January 2021).

III. <u>Enforcement battles with Tanzania</u>

In Tanzania, the late president John Magufuli was a committed resource nationalist, making it a core part of his political brand – a telling sign that arbitration or other forms of formal dispute resolution are unlikely to prove fruitful. In 2017, Magufuli ushered in the passage of punitive domestic legislation which effectively allowed the state to rip up existing contracts at will if they constituted "unconscionable terms" while entirely banning the use of any "foreign court or tribunal" as a medium of dispute resolution relating to natural resources.

Tanzania also passed legislation that banned the export of raw resources – an export ban that affected copper and gold miner Acacia Mining

especially hard. The government hit Acacia with an absurdly high USD 190 billion tax bill in 2017, which prompted the mining company to launch arbitration proceedings against the government. However, Acacia recognised from the start that a resolution to the dispute would likely come outside the courtroom, with the company stating at the time that it "remains of the view that a negotiated resolution is preferable to the current disputes and the company will continue to work to achieve this" (https://www.ft.com/content/a129cec7-de8a-35b7-8a75-4f8bf64b902f, last accessed on 21 October 2021). Arbitration thus served as an avenue for the investor to apply pressure on Tanzania while its good chance of winning held out the prospect of increasing its valuation in a future sale.

For Acacia, the solution to the dispute was to play into the government's priorities. Acacia announced a stay in arbitration proceedings in 2019 before being re-acquired by Barrick Gold for USD 1.2 billion (https://www.reuters.com/article/us-acacia-mining-tanzania-idUSKCN1UC0T6, last accessed on 21 October 2021). Barrick Gold, now managing Acacia's assets, came to a USD 300 million settlement with the government, while also agreeing to form a joint partnership with the government to manage its assets in Tanzania (https://www.barrick.com/English/news/news-details/2019/The-Launch-of-Twiga-Minerals-Heralds-Partnership-Between-Tanzanian-Government-and-Barrick-/default.aspx, last accessed 21 October 2021).

IV. Enforcement battle with Russia

Among the more infamous of such disputes was the years-long saga of BP's joint venture in Russia, TNK-BP. The joint venture between BP and four Soviet-born oligarchs (https://www.theguardian.com/business/2011/may/17/aar-billionaire-oligarchs, last accessed on 21 October 2021), which came to an end when BP sold its 50 percent stake to state-owned oil giant Rosneft is a case study in the need for a political risk mitigation strategy to complement black letter legal advice. While the two parties battled it out in multiple arbitration tribunals (https://www.ft.com/content/baeea4f4-4cd4-11e0-8da3-00144feab49a, last accessed on 21 October 2021) and in Russian courts (https://www.reuters.com/article/us-bp-russia-damages-idINBRE86Q0MT20120727, accessed 21 Oct 2021), the joint venture's BP-appointed CEO Bob Dudley was chased out of Russia and denied a visa after facing an "orchestrated campaign of harassment," (https://www.theguardian.com/business/2008/jul/25/bp.oil, last accessed on 21 October 2021), while BP was "hit with billion-dollar back tax claims, [and] having its offices searched by the successor to the Soviet-era KGB," (https://www.risk.net/commodities/energy/2253578/tnk-bp-saga-raises-questions-about-bps-handling-political-risk, accessed 21 Oct 2021), while BP employees were convicted of espionage in sham trials in Russia (https://www.reuters.com/article/russia-espionage-bp-idUSL797667620090507, last accessed on 21 October 2021).

For BP, what appeared to be a disaster in the making in fact resulted in a financially positive outcome. While it lost its controlling stake, the British oil giant sold its stake to Rosneft for USD

17.1 billion and a 12.84 percent stake in the state-owned oil major (https://www.bbc.com/news/business-20030610, last accessed on 21 October 2021), and Bob Dudley – retired from BP – now sits as a Rosneft board member (https://www.rosneft.com/governance/board/item/6081/, last accessed on 21 October 2021). The TNK-BP case still presents numerous lessons: what may appear to be a legal dispute may in fact be politically motivated, and especially when it comes to the extractives sector, the state may prioritise control over all else. What is more, the case again demonstrates that without a wider strategy accounting for political and reputational issues, strictly legal avenues to dispute resolution may prove insufficient. This of course changed dramatically in February of 2022 after Russia's invasion of Ukraine and BP announcing that it intended to divest from Russia. (https://www.bloomberg.com/news/articles/2022-03-10/bp-leaves-russia-after-ukraine-invasion).

Foreign investors must also be aware that domestic courts can be weaponised on behalf of politically connected local partners, as appears to have happened in the ongoing battle between Russia-based American investor Michael Calvey in a dispute with his former business partner, Artem Avetisyan, who is said to enjoy a close relationship with Russia's Deputy Prime Minister (https://www.ft.com/content/4f9e0995-26ba-45af-8f29-f426517e9a30, last accessed on 21 October 2021). Calvey is accused of defrauding and embezzling a Russian bank in a fight over its control and spent nearly two years in house arrest before being given a 5.5 year suspended sentence in a court decision that could hardly be described as impartial (https://www.dw.com/en/russia-us-investor-michael-calvey-receives-suspended-sentence/a-58788389, last accessed on 21 October 2021).

V. Conclusion

Avoiding intractable disputes with local partners or host governments should be a top priority for any company operating in challenging emerging markets. While disputes do not often make headlines until they reach their bitter climax in an arbitral tribunal or similar forum, numerous steps can be taken to minimise reputational, operational, and financial risk. This highlights the importance of protecting a company's social license to operate. Not only does this ensure that trust is maintained between an investor, the host government, and its citizens for smooth commercial operations, it also means that if a dispute does arise the investor will have political and social capital to protect its interests alongside its legal options.

Often, this is about listening and understanding the host government's priorities. For Magufuli's Tanzania, it was greater control of its mineral resources through a joint venture, and the public perception of a victory through the USD 300 million settlement; for India in its disputes over retroactive taxes, it aimed to halt the increasingly dire reputational damage while reaching a settlement that didn't look like a settlement – rescinding the controversial tax law was "a settlement offer masquerading as a law," as one observer put it (https://www.ft.com/content/0f73fe20-1925-488e-bb2f-e56dd08f1653, last accessed 21 Oct 2021). Lawyers advising their clients on any

dispute should be encouraged to think about the wider position of their clients and their reputation, while understanding the political environment, geopolitical drivers, relationships with civil society and the media landscape.

Simon Wolfe, LL.M.

Simon Wolfe is an international lawyer, advocate and Founder / CEO of Marlow Strategy, a geopolitical advocacy and communications firm.

Email: swolfe@marlowstrategy.com