SCHLÜTER GRAF

Adequate Legal Measures in Times of Foreign Policy Conflicts

During the last year several political issues arose between Germany and some of its trading partners. Companies with a hub in Dubai carrying out business with Qatar continue to face difficulties due to the tense political relations with the Kingdom of Saudi Arabia (KSA) and other members of the Gulf Cooperation Council (GCC). In summer 2017, German companies were subjected to black-listing in Turkey. Last but not least, there have been rumours that German companies are facing challenges in KSA. This legal briefing gives an overview of measures that should be taken into account in these times of political tensions.

1. What is the issue?

Political disputes have led to constraints with regard to investments in Turkey and KSA. The same applies to Qatar business that has been facilitated through the UAE in the past. From a contractual perspective, investors would need to keep in mind how certain political risks can be mitigated. This can be done through Force Majeure and/or Hardship Clauses. Regardless of the contractual provisions, investors would need to familiarize themselves with investment protection.

2. What to consider in contracts?

To avoid negative consequences caused by (unpredictable) political tensions, it is advisable for the investor to include so-called Hardship and/or Force-Majeure clauses in their contracts. These clauses facilitate legal certainty with regard to political disturbances (but also natural disasters).

2.1 Force-Majeure clauses

Force-Majeure clauses regulate the occurrence of events that could not have been foreseen when the contract was concluded, nor could have been averted if the usual care had been taken in international trade.

Typically, Force-Majeure clauses contain a broad range of so-called pre-defined "Force-Majeure events". These events can generally be divided into two categories:

- Political Force-Majeure; and
- Non-political Force-Majeure.

The political Force-Majeure describes risks that generally relate to changes in the political environment. These include, for example, embargoes, riots or terrorist acts as well as regulatory aspects such as legislative reforms.

The non-political Force-Majeure describes physical risks that could affect investments, such as: storms, earthquakes and other natural disasters.

However, there is no standard definition for

Force-Majeure clauses and when drafting such clauses investors need to ensure that the (political) event in question is covered by the Force-Majeure clause.

2.2 Hardship Clauses

Hardship clauses regulate the change of the commercial basis. The contract's balance can be disturbed if events are not taken into account when the contract is concluded or if unforeseeable events occur.

There are several possibilities for the design of hardship-clauses:

- Unilateral option for one party to modify contract terms if certain conditions are met;
- Price adjustment clauses to adjust the contractually agreed prices to the seller's purchase costs; or
- Re-negotiation obligation in the event of certain, predefined situations.

2.3 Alternative Logistics Solutions

Due to embargo-like restrictions (e.g. as applied by some Arab states vis-à-vis Qatar), many companies are forced to re-route shipments based on existing binding orders.

Such measures do not only add cost but also contain legal risks which are oftentimes not recognized. For example, when alternative transport routes are used, this is generally done through existing logistics providers. These providers will usually involve third-parties (often without the explicit knowledge of the shipper) as trading and/or logistics partners. The shipper will likely have no contractual ties with such third-parties who are liable to carry out certain services and may in the process become the legal owner of the shipper's goods.

Ideally, in order to safeguard against potential damages or losses, companies should enter into adequate contractual arrangements with their logistics partners (including third parties used by such partners).

3. Bilateral Investment Treaties (BIT)

Worldwide there are approx. 3,000 BITs and multilateral investment treaties in force. In the post-war period, Germany took a leading role in establishing and expanding this network. Through BITs, states (home state) secure investment protection for their investors in the respective host state. BITs impose a number of specific obligations on the host state for the treatment of foreign investments.

One differentiates between absolute and relative protection standards:

Absolute standards:

- Protection against unlawful expropriation;
- Fair treatment;
- Extensive protection and security;
- Umbrella clauses; and
- The right to unrestricted profit transfer.

Relative standards:

- Most-favoured-nation treatment; and
- Protection against discrimination.

Among other things, BITs aim at protecting investors from political risks, i.e. from measures or decisions emanating from the host state and affecting foreign investment. BITs typically include the following forms of dispute resolution:

- State-State Dispute Settlement (SSDS); and
- Investor-State Dispute Settlement (ISDS).

With the SSDS, only the respective contracting parties, i.e. the signatory states, have the possibility to call in an investment arbitration. This legal protection option is included in both old and new BITs.

However, modern BITs allow the investor to assert rights from the respective BIT directly against the host state. ISDS, therefore, allows the investor to assert his rights directly, instead of going through the contracting party.

Older BITs, however, do not contain respective ISDS provisions. For example. this is the case for the BIT concluded between Germany and Turkey. In such a case, the investor would be dependent on the contractual partner, i.e. Germany, to settle an investment dispute.

4. Treaty-Shopping

Based on the above, investors falling within the scope of an old BIT should consider restructuring their investment to ensure that their business falls under a modern BIT which contains an ISDS clause. In general, it is permissible to structure an investment in such a way that BITs from other countries can be facilitated. In most of the cases this is done by establishing a subsidiary in the host country. An alternative method is that the company shares are transferred by the investor to a subsidiary in a third country, which has better investment protection conditions (BIT) with the host country.

However, states reserve their right to deny the benefits of a BIT to an investor who has no economic ties with the state whose nationality it relates to. Such anti-treaty-shopping rules are especially included in newer BITs.

Even if no anti-treaty-shopping clauses are contained in the respective BIT, there are various aspects to treaty-shopping that must be considered to ensure that in the event of a dispute, the “new nationality” is also recognised as admissible by an arbitral tribunal. Among other things, typically, time objections are examined by arbitral tribunals with regard to whether the dispute was predictable when initiating the restructuring process. In other words: If a dispute was foreseeable at the time of restructuring, the investment dispute may be dismissed. However, if the restructuring has been planned ahead early enough, it would be considered admissible by an arbitral tribunal.

5. Conclusion

As foreign policy and its impact on investments become less predictable, investors should draft their contracts in such a way that they can react to short-term changes by mitigating damages. It is advisable to

concentrate on the following tools:

- Force-Majeure Clauses;
- Hardship-Clauses; and
- Modern BITs

Force-Majeure and Hardship-clauses should be drafted as comprehensively as possible and alternative logistics routes should be covered by adequate contracts. If feasible, investors should restructure their investment so that it falls under a favorable BIT.

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