Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Planning For Disputes In Cross-Border PE Deals

Law360, New York (October 15, 2014, 10:29 AM ET) --

Timothy J. Lindsay

As private equity houses venture further into foreign, emerging and frontier markets in the search for yield, planning for future disputes — whether with vendors, fellow shareholders, local joint venture partners, important suppliers or other counterparties, or host governments — is a critically important tool to manage the risks associated with such investments. International arbitration can offer important advantages in cross-border transactions, with the precise wording of the so-called "midnight" dispute resolution clauses in commercial agreements being the keystone to contractual certainty and, ultimately, enforcement of the bargain struck.

Importance of Planning for Disputes

Disputes planning should provide answers to three preliminary questions that arise in every cross-border controversy: where, by whom and by which legal rules will this dispute be decided?[1] The answers to these questions can be decisive to the outcome on the merits of a dispute, the availability of monetary damages and other relief (such as specific performance and injunctive measures), the ultimate enforceability of the judgment or award, the speed and flexibility of the proceedings, and the neutrality and fairness of the process. Indeed, the more predictable the outcome of future disputes, the greater contractual certainty will be during the term of the contract.

Advantages of International Arbitration for Cross-Border Private Equity Transactions

Contractual rights are the lifeblood of international commerce, and are especially critical to private equity managers and investors who are increasingly investing internationally and in emerging markets, often alongside local partners and/or in politically important industries.

International arbitration seeks to aid in the legal predictability and stability of international contracts by providing for the impartial, centralized, and final and binding resolution of disputes arising out of international contracts:

- ***Neutrality.*** To avoid perceived (or, worse, actual) impartiality of domestic courts and "home court advantage," international arbitration provides for a neutral forum, neutral arbitrators,

neutral governing law and neutral procedures. The demand for neutrality means arbitration is, as a practical matter, often the only possible agreed forum for disputes arising out of cross-border contracts.

- ***Centralized Forum***. By agreeing to exclusively arbitrate disputes arising out of their contractual relationship, those disputes are centralized in one forum. This minimizes the risk of litigating the same dispute in multiple different courts in different jurisdictions.

- ***Final and Binding Adjudication.*** Arbitral awards are final and binding on the parties and they are only permitted to be appealed or challenged on very limited grounds.[2]

- ***Enforcement "Premium" of Arbitral Awards (i.e., Avoiding Pyrrhic Victories).*** The most important feature and advantage of international arbitration is the near-worldwide enforceability of international arbitral awards pursuant to the recognition and enforcement regime created by the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"). The New York Convention obliges convention states (now over 150) to ensure foreign arbitral awards are recognized and capable of enforcement in their jurisdiction in the same way as domestic awards, thereby precluding discrimination against foreign arbitral awards and providing for straightforward enforcement where necessary. With court judgments enjoying no similar international enforcement framework, this is commonly referred to as the arbitration "enforcement premium" and is one of the primary reasons why parties to international contracts arbitrate disputes arising out of those agreements.

- ***Procedural Flexibility.*** The hallmark of international arbitration is the procedural autonomy parties and arbitral tribunals enjoy to agree to the procedures most suitable for the circumstances of their particular dispute. While domestic court procedures are often prescriptive and onerous and courts slow to deal with disputes, parties to arbitration enjoy very wide autonomy to agree on appropriate procedures and arbitrators have flexibility to adopt them. If parties seek efficiency and speed, then they can readily agree to procedures and appoint an appropriate tribunal to achieve those objectives. International arbitration is also a private process, and in most cases will be confidential provided parties specifically contract for confidentiality in their contract.

- ***Availability of Injunctive and Interim Relief.*** The arbitration rules of all of the leading international arbitration institutions (ICC, AAA-ICDR, LCIA, HKIAC, SIAC, Swiss Rules) and the governing arbitration legislation in most of the leading seats of international arbitration (London, Paris, Geneva/Zurich, Hong Kong, Singapore and UNCITRAL Model Law) all permit parties to seek urgent injunctive relief from domestic courts of competent jurisdiction prior to the formation of the arbitral tribunal (and in appropriate cases after), and all leading rules

empower arbitral tribunals to grant such injunctive relief themselves. Several institutions have gone further (ICC, AAA-ICDR, LCIA, SIAC, HKIAC, Swiss Rules) and provide also for the appointment of a so-called “emergency arbitrator” to be appointed and make interim orders on short notice in advance of the confirmation of the full tribunal.

These features have seen arbitration become the predominant means of resolving cross-border disputes, particularly those arising out of transactions in the emerging markets. That said, commentators who suggest either litigation or arbitration is — by definition — superior for PE-related (or any other) disputes ignore the practical legal and enforcement aspects of particular transactions: neutrality is commendable, but where am I likely to be most successful? Can I successfully enforce my judgment or award in jurisdiction "X"? Is confidentiality important? What are my options if I need to compromise on my preference? Are there issues of sovereign immunity? The most appropriate choice will need to be assessed deal by deal.

Structuring Deals to Protect Against Sovereign Risk: International Investment Agreements

At the same time as planning for future disputes with contractual counterparts, important trade benefits and investment protections are offered to foreign investors by many states under bilateral investment treaties (BITs) and bilateral and multilateral trade and investment agreements — the most important being the ability to directly seek recourse by international arbitration against host states for expropriation and other wrongful interferences with foreign investments.

Thus, in addition to minimizing contracting and enforcement risks, private equity managers making foreign investments are increasingly structuring investments to take advantage of the investment benefits and protections of BITs and other international investment agreements, such as the Energy Charter Treaty and the increasing body of bilateral and multilateral free trade agreements. These international treaties contain reciprocal promises to encourage foreign direct investment from nationals of the other state and important substantive protections for investments so made.

There are three important features of such trade pacts that are of particular importance for private equity managers.

- ***Qualifying “Investments.”*** Under international law, the definition of a qualifying “investment” is typically very wide, and under most BITs refers to “every kind of asset” followed by an illustrative but usually nonexhaustive list of assets that often includes movable and immovable property, interests in companies (e.g., shares, stocks and other forms of equity participation in an enterprise), claims to money and claims under a contract having a financial value (including loans, bonds, debentures and other debt instruments), and intellectual property rights.

- ***Substantive Trade Benefits and Investment Protections.*** While these vary from BIT to BIT, the substantive protections offered by host states to investors from the other contracting state most commonly include a promise not to expropriate (directly or indirectly) the investor’s investment without prompt payment of adequate compensation, to afford the investor “fair and equitable” treatment, to treat the investor no less favorably than the host state’s nationals (nondiscrimination) and to treat the investor no less favorably than the host state offers to treat investors from other states (as a most-favored nation).

- ***Direct Recourse by Arbitration Against the Host Contracting State.*** While historically, foreign investors have had to rely on government-government diplomacy in the event a host state interferes with an investment, a critical innovation of BITs has been to provide foreign investors with the ability to directly seek recourse against the host state by international investment arbitration. This arises from a state's freestanding offer in most BITs to arbitrate investment disputes with foreign investors. The past decade has seen a marked increase in the number of investment arbitration claims by foreign investors against host states,[3] and investor-state arbitration is now seen as an important way for investors to vindicate and enforce their rights and seek fair compensation where appropriate.[4] Investor-state arbitrations are commonly brought by investors at the World Bank's autonomous international institution, the International Centre for Settlement of Investment Disputes, established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "Washington Convention") — to which over 150 states are party.

Given these valuable benefits and protections, it is important for private equity managers to assess whether their investment will enjoy investment protection under an applicable BIT or trade agreement. If there is no applicable BIT or trade pact, it may be possible for private equity investors to structure their investment to obtain BIT coverage (and investors commonly do so). Each case will necessarily be fact- and BIT-specific, and specialist advice will be necessary to ensure, so far as possible, that investments benefit from BIT protection under international law.

Drafting Your Arbitration Agreement

Arbitration between commercial parties is a creature of contract. Parties must contract to arbitrate future disputes to the exclusion of domestic courts or other forums. As noted above, whether arbitration is the best choice of forum will need to be determined in the circumstances of each transaction.

If arbitration is the most appropriate dispute resolution mechanism, however, then the best combination of governing law, arbitral institution (e.g., ICC, AAA-ICDR, LCIA, SIAC), seat and other necessary provisions will need to be considered and, usually, negotiated. Professional advice on these matters should always be sought.

Conclusion

Appropriate dispute planning can avoid the pitfalls of local courts and the risk of parallel litigations in multiple jurisdictions, and avert pyrrhic victories by ensuring the enforceability of any future judgment or award. At the same time, important trade benefits and investment protections offered to foreign investors by many states under bilateral investment treaties, multilateral treaties (e.g., the Energy Charter Treaty) and other trade agreements should not be ignored by private equity managers — who can unlock coverage under these treaties and sovereign risk protections with appropriate deal structuring.

—By Timothy J. Lindsay, Dechert LLP

Timothy Lindsay is a partner in Dechert's international arbitration practice, resident in the firm's London office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] See e.g., the discussion in Born, International Commercial Arbitration, p. 65 et seq (2009)

[2] Most leading international arbitration rules seek to exclude as far as possible the ability of parties to appeal arbitral awards, whether on issues of fact or law. See e.g., ICC Rules (2012), Art. 34(6).

[3] International Centre for Settlement of Investment Disputes, ICSID Caseload — Statistics, July 30, 2014, at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement155

[4] See generally e.g., Newcombe & Paradell, Law and Practice of Investment Treaties, (2009)