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Insights

International Arbitration Group

Securing International Law Protections for Brazilian Outbound Investments Against Geopolitical Risks

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Executive Summary:

Brazilian investors investing outside of Brazil in jurisdictions all over the world should structure their investments through jurisdictions chosen not just for tax purposes but also for investment protection through bilateral investment treaties. This insight explains why such planning and structuring is especially important for outbound investment in sectors that are heavily regulated by governments.

- Brazilian investors are increasing their levels of foreign direct investment (FDI) outside of Brazil.
- Investors making outbound investments usually route their investments overseas through special purpose vehicles (SPVs) that are incorporated in tax friendly jurisdictions, such as the Cayman Islands, British Virgin Islands, Bahamas, Luxembourg, and the Netherlands.
- These investors should also explore whether bilateral investment treaties (BITs) may protect their investments overseas, especially when investing in heavily regulated sectors in other jurisdictions, such as banking and finance, defense, life sciences, natural resources (energy and mining), and information technology.
- BITs protect foreign investors from unlawful actions taken by the government of the host State of the investment (the destination of the outbound FDI). The term “investors” in most BITs usually is defined broadly, to include nationals of a country as well as companies incorporated in the State making the outbound investment. The investments belonging to the investors that are protected by BITs usually are broadly defined, too, to encompass “any kind of asset” held or maintained in the receiving State.
- BITs provide international law protections to investors and investments from acts of the government of the host State of the investment. Such protections include a prohibition against expropriation of the investment, and a guarantee of fair and equitable treatment of the investor and its investments. Other protections include the right of the investor to repatriate returns on its investment without arbitrary restrictions. Critically, most BITs allow the foreign investor to arbitrate its dispute under the BIT directly against the host State government, taking the dispute out of the local courts that likely would play favorites.

- While Brazil has signed 30 BITs with other governments, it has ratified only three of them (with Angola, Chile and Mexico). However, Brazilian BITs do not contain the right for the investor to arbitrate disputes with the host State directly in a private forum. Rather, most Brazilian BITs contain a mechanism that allows representatives of the Brazilian government to engage with representatives of the government of the host State to try to resolve the dispute.
- Brazilian investors should consider routing their outbound investments through jurisdictions that are not only tax friendly but also have executed BITs with the host States that ultimately will receive the Brazilian FDI. If the government of the host State breaches the protections of an applicable BIT, then the SPV, as the foreign investor, could sue the government under the BIT regarding the impact of the government's unlawful actions on its investment. If the SVP prevails in the arbitration, it would be awarded monetary damages that it could pass back to the ultimate beneficial owner, i.e. the Brazilian investor.
- SPVs that are under the control of Brazilian investors already have initiated arbitrations against host States that have enacted measures impacting their investments. For example, Brazilian telecommunications company Oi initiated an arbitration against Cape Verde through its Portuguese subsidiary PT Ventures using the protections in the 1990 Portugal-Cape Verde BIT. Similarly, BA Desarollos, a Delaware company owned by Brazilian investors, initiated an arbitration against Argentina under the US-Argentina BIT challenging actions taken by the Argentine State Assets Administration Agency to develop land purchased by BA Desarollos in Argentina.

Accordingly, Brazilian investors should consider structuring their outbound FDI through SPVs incorporated in jurisdictions that have robust BITs in force with the destination of the outbound FDI. Jurisdictions that are known for being tax friendly, and which ratified double taxation treaties with Brazil, such as Luxembourg, Mauritius, the Netherlands, Panama, Singapore, Switzerland and the United Arab Emirates, also have ratified many such BITs with governments all over the world. Thus, tax planning and investment treaty protection should be considered together.

Introduction

Brazil has become a major destination for FDI, receiving more than half of all South America's inflows in recent years. Brazil deploys a methodical approach to attracting FDI. On the front end, the Brazilian Trade and Investment Promotion Agency facilitates inbound foreign investment, notably by identifying business opportunities, performing market analyses, and generally assisting foreign investors in navigating the Brazilian legal landscape. On the back end, the Direct Investments Ombudsman acts as an intermediary between various governmental agencies and foreign investors to help address complaints or issues raised by foreign investors.

At the same time, Brazilian multinationals have become major economic players worldwide, with reported outbound investments exceeding US$30 billion in 2022. Brazilian investments abroad appear to be routed through the Caribbean (i.e., the Cayman Islands, British Virgin Islands and Bahamas) and Europe (primarily the Netherlands and Luxembourg). These flows reflect a deliberate choice to route investments through special purpose vehicles in jurisdictions known for offering favorable tax regimes and having treaties with Brazil for the prevention of double taxation. The final destinations of Brazilian outbound FDI are located all over the globe, however, even if they tend to be routed through these tax-friendly jurisdictions.

Brazil is unusual when compared to its peers (especially the BRICS[1] countries), in that while it has signed over 30 bilateral investment treaties, it has ratified only three of them with Angola, Chile and Mexico. More surprisingly, none of the BITs that Brazil has signed or ratified allows for private resolution of disputes brought by foreign investors under those agreements against the Brazilian government through arbitration. While this strategy may make sense with regard to protecting Brazil from claims raised by foreign investors who are investing in Brazil, it does leave Brazilian investors investing in capital-intensive projects overseas exposed to unlawful acts by governments in jurisdictions where they are investing.

[1] BRICS is an intergovernmental organization comprising Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia and the United Arab Emirates.

What are BITs?

BITs, or investment chapters contained in free trade agreements, are treaties signed by two countries to protect foreign investors possessing the nationality of one of the countries and their investments when investing in the territory of the other country (the "host State"). While the content and scope of each BIT will vary, generally, BITs protect:

1. Foreign Investors
    a. Foreign investors typically include natural persons holding citizenship in the State of outbound investment as well as companies incorporated or registered in accordance with the laws of that State.
    b. Certain BITs may contain additional requirements for a legal person to qualify as a protected investor, such as:
        i. the legal person must have its headquarters in that State of outbound investment (as opposed to a third State). This is the case, for example, of the BIT between Brazil and Malawi.
        ii. The legal person must have "substantial business activities in the territory" of that State of outbound investment. This is the case, for example, of the BIT between Brazil and India.
2. Investments
    a. Protected investments often encompass "any kind of assets" held in the host State and include movable and immovable property, shares, bonds and claims to performance of economic value. This is the case, for example, in the BIT between Brazil and the Belgo-Luxemburg Economic Union.
    b. Certain BITs may contain additional requirements for an investment to quality as a protected investment, such as that:
        i. The investor must be able to "exert control or significant degree of influence over the management of the production of goods and provision of services" in the host State, as is the case of the BIT between Brazil and Ethiopia.
        ii. The investment display "the characteristics of an investment, including the commitment of capital, the objective of establishing a lasting interest, the expectation of gain or profit and the assumption of risk," as is the case of the BIT between Brazil and India.

BITs typically provide the following substantive protections to a foreign investor and or its investment:

1. National treatment: Foreign investors should be treated no less favorably than domestic investors in like circumstances.
2. Most-favored-nation treatment: Foreign investors should be treated no less favorably than investors from third countries. This protection may be helpful should the government treat third-country investors more favorably by granting their permits on an accelerated basis or by offering their investments better tax or other economic incentives.
3. Fair and equitable treatment: The host state should respect the legitimate expectations of foreign investors at the time they made their investments, and should treat foreign investors and their investments transparently, consistently, with stability, and in good faith.
4. Expropriation: The host state may not expropriate the investment or enact measures tantamount to expropriating the investment unless done for a public purpose, in a non-discriminatory manner, in accordance with due process, and with the payment of prompt, adequate, and effective compensation.

5. International arbitration: Many investment treaties permit private arbitration of disputes between an investor and the host state, thereby taking the dispute out of the national courts, which may play favorites.

Brazil and BITs

Brazil has signed over 30 BITs but has ratified only three of them. While the BITs that are in force contain the protections that are found in BITs generally, they uniformly do not allow for foreign investors to arbitrate disputes directly against the host State regarding measures enacted by the host States that impact their investments. This is a major limitation.

Instead of a dispute resolution mechanism, Brazil's BITs utilize a two-stage "dispute prevention" mechanism. At the first stage, national focal points serve as ombudsmen in managing issues arising between the host State and the investors' home State, which includes avoidance of escalation of issues into legal disputes. At the second stage, if the issues escalate into legal disputes, "joint committees" comprised of government representatives from the two States hear the aggrieved investor's complaint with the objective of reaching an amicable resolution between the two sides. If these efforts fail, the foreign investor's last resort is to seek diplomatic protection from their home government. The Brazilian treaties permit inter-state arbitration, such that the home State (for example, Brazil) could theoretically espouse the claims of the investors (for example, the Brazilian investors) and arbitrate the matter against the host State in the investor's stead.

Ultimately, it is very unlikely that the home state of the investor will engage in inter-state arbitration with the host State. The foreign investor realistically would have to be politically connected and the claims would need to be sizable in monetary damages for the home State to espouse the claims. In any event, these limited dispute-prevention mechanisms are only available to Brazilian investors who have disputes against Angola, Chile, and Mexico given that Brazil only has ratified BITs with three States. But if Brazil does not espouse the claims of Brazilian investors against any of these three States, then the only judicial recourse those Brazilian investors would have would be in the home courts of those three States.

Brazilian Investors Are Increasingly Exposed to Geopolitical Risk

The majority of Brazilian investors operate in the extractive industries, information technology or financial services. Brazilian energy and mining companies direct their outbound FDI towards resource-rich States such as Argentina, Chile, Gabon, Guinea or Mozambique. IT services companies establish operations in States such as the United Kingdom, the United States and Japan. Companies in the industrial equipment and automotive industries may be present in States such as Germany, while companies in the cosmetic industry may have operations in France.

Investment treaty disputes between foreign investors and the host States of their investments have been steadily on the rise. This rise concerns all sorts of business sectors, including sectors in which Brazilian Outbound Foreign Direct Investment ("OFDI") is concentrated.

1. **Extractive Industries:** Historically, over 16% of all known treaty-based investor-state arbitrations against host States have concerned investments in extractive industries, making it the most disputed industry as a whole for this category of disputes. These cases usually are brought in response to a host State's decision to develop, modify, or implement laws and policies governing extractive industry investments—whether through legislation, court decisions or administrative actions. They may relate to heightened environmental and social concerns, a desire to capture a greater share of the windfall that an extractive project generates, or simply to nationalize a foreign-owned asset or entire industry. Investors usually challenge a sovereign's measures pertaining to:

    a. Revocation or termination of the investor's concession rights.

b. Withholding of permits required to operate, often coupled with the enforcement of environmental regulations, such as the requirement to consult with local communities, perform environmental impact assessments, or obtain a "social license."

c. Enactment of more stringent environmental regulations.

d. Changes to the host State's fiscal regime or targeted imposition of tax-related measures (e.g., windfall taxes) or royalties.

e. Termination of investment contracts with investors.

2. **Financial Services**: As many states have been adopting more interventionist approaches to their financial sectors in recent past, banks and financial institutions operating abroad have become more exposed to geopolitical risks potentially affecting the value of their investment. By way of examples:

   a. Argentina's default on its sovereign debt and restructuring in the mid-2000s triggered numerous claims by disgruntled investors, including the first "mass arbitration" involving tens of thousands of Italian retail holders of Argentine sovereign bonds.

   b. Indonesia's bailout of a bank following the sub-prime crisis, which entitled the government to equity interests in the rescued bank, led to the filing of two ISDS cases by investors diluted by the bailout, the first from a Saudi investor and the second by a British investor.

   c. The downgrading of Greek debt, adoption of austerity measures and sovereign debt restructuring, caused Slovak bondholders to bring a claim against Greece.

   d. The Swiss central bank's decision in 2015 to abandon exchange rate controls, which resulted in the removal of any caps on the value of the Swiss franc, caused investors to bring a claim against Croatia and another claim against Montenegro following these respective states' decision to compel the conversion of franc-denominated loans into Euros.

3. Information Technology: With the advent of the technological era came an increase in government regulations, aimed at cybersecurity, data protection, online content, competition, and consumer protection. As they navigate a dynamic and fluid regulatory landscape, technology companies are increasingly turning to available international fora to seek redress, including resorting to investor-State dispute settlement. For example:

   a. Uber initiated a proceeding against Colombia after the Colombian authorities banned its ride-hailing services (the proceeding was later discontinued after the Colombian judiciary overturned the authority's ban).

   b. Neustar brought a claim against Colombia for violation of the Colombia-U.S. Trade Promotion Agreement in connection with Colombia's decision not to renew the concession held by the claimant's wholly owned local subsidiary for the operation of a domain name.

   c. Huawei brought a claim against Sweden following the Swedish telecom regulator's decision to bar Huawei's and ZTE's access to an auction for obtaining a license to the Swedish 5G network over national security concerns.

Brazilian Investors Should Structure Their Outbound Investments to Benefit from The Protections of Investment Treaties

Investors need to plan ahead to address the risk of the host State changing the economic rules of the game over the course of an investment's lifetime, which could adversely impact the return on the investment ("ROI") significantly. After all, it is possible that new laws and regulations will be enacted that will change the key economic inputs into calculating the ROI, such as new tariffs, taxes, and royalties. Additionally,

local authorities might fail to honor their end of the bargain such that a project will not be successful. For example, governmental authorities might not approve permits in a timely manner or deny permits arbitrarily.

Thus, Brazilian investors who are making OFDI should consider structuring their investments through SPVs incorporated in jurisdictions that are both tax friendly (that is, jurisdictions that have low tax rates and/or offer tax incentives to foreign investors) but also have entered into BITs with the host state where the investment is being made. In this way, depending on the terms of the specific BIT, the SPV could serve as the claimant in any arbitration against the host State regarding acts that breach the obligations and protections afforded to investors in the BIT.

By way of example, in 2015, Brazil's telecommunications company Oi brought claims against Cape Verde through its Portuguese subsidiary PT Ventures under the 1990 Portugal-Cape Verde BIT. PT Ventures had acquired a stake in CV Telecom as part of Cape Verde's privatization of the company in 1996. When Oi merged with Portugal Telecom in 2014, PT Ventures' stake in CV Telecom was transferred to Oi, which prompted Cape Verde to invalidate Oi's shareholding in CV Telecom. The arbitration concluded with a settlement in terms favorable to Oi.

Another recent example is a case filed by BA Desarrollos, a Delaware company reportedly owned by the Brazilian Safra family, against Argentina under the US-Argentina BIT. BA Desarrollos holds an investment in an Argentine real estate trust (BAP) that acquired two plots of land in an upscale neighborhood of Buenos Aires. Argentina's State Assets Administration Agency reportedly thwarted BAP's plan to develop the land, prompting BA Desarrollos to file an arbitration against the Argentine government in August 2023, which is pending.

Often, in structuring their investment, foreign investors involve at least one entity in a tax-friendly jurisdiction that also has numerous investment treaties, as well as treaties for the avoidance of double taxation (Double Taxation Treaties or "DTTs"), in force such as the following:

Tax-Friendly Jurisdiction	**BITs in force**	**DTTs in force**
Netherlands	74	102
Luxembourg	59	86
Singapore	39	97
United Arab Emirates	74	137
Mauritius	26	46
Switzerland	109	96
Panama	17	15

Not all BITs are equal in terms of scope and levels of protections afforded to foreign investors. For example, treaties (and principles of international law applicable to treaties) may impose restrictions on who may qualify as an investor:

- The definition of the term "investor" may impose the additional obligation that the legal person incorporated in a contracting party also have its headquarters in that contracting party.
- Treaties may contain "denial-of-benefits" provisions that require an investor to not simply be incorporated in a state but actually do substantial business activity in that jurisdiction.
- It may not be permissible for a foreign investor to avail of the protections of a treaty if it restructured its investments at a time when a dispute with the host state of the investment was underway or was

reasonably foreseeable. Such restructuring may be characterized as abusive “treaty shopping.” The requirements in a treaty to qualify as an investor and the timing of the structuring of the investment must be considered very carefully.

As such, the corporate structuring of an investment requires a thorough analysis by the investor to answer these questions when routing investments through a third jurisdiction:

- What is the ultimate target destination (who is the host State)?
- With which third states has the host state ratified BITs?
- From that list of BITs between the host state and the third state, which third states are tax-advantageous or tax-friendly jurisdictions in which to incorporate an SPV?
- Are the treaty protections in those BITs sufficiently robust?

This (re-)structuring of the investment should ideally be done up front at the time of the investment. Otherwise, it may end up being too late if not done by the time a dispute materializes.

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