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The *Portigon v. Spain* Decision: Upholding International Law Protections for Financial Instruments

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In a win for private equity firms and financial investors, the international arbitration tribunal in *Portigon AG v. Kingdom of Spain* has recently confirmed that project finance loans and hedging instruments constitute protected investments under two major treaties, the Energy Charter Treaty and the ICSID Convention. This decision illustrates the valuable international law protections potentially available to private equity firms and is the latest in a line of cases to confirm that those protections apply equally to investments in equity and debt.

Investment Treaty Protection for Financial Instruments

As set out in *Investment Treaties and Investor-State Arbitration: Tools to Manage Political Risk in Emerging Markets*, published by EMPEA in October 2020 ("***Investment Treaties***"),[1] a global network of thousands of international investment treaties grant substantive protections to qualifying investors and their foreign investments around the world. These treaties often include a right to bring legal claims directly against the host State through international arbitration for violations of the substantive protections. Such protections typically include protections against expropriation without compensation, and rights to fair and equitable treatment and to freely transfer assets out of the State.

For private equity investors, particularly those targeting emerging markets, the availability and scope of investment treaty protection provide valuable mitigation against country risk, including political, regulatory and expropriation risk.

To gain access to the substantive and procedural protections afforded by international investment treaties, a foreign investor must typically demonstrate that it satisfies certain nationality requirements set forth by the treaty and that it has a qualifying "investment" as defined in the treaty. In recent years, and as previewed in *Investment Treaties*,[2] the definition of a qualifying "investment" has expanded to encompass intangible assets.

In particular, debt and other financial investments have become increasingly prevalent in investment-treaty jurisprudence

[1] J. Williams, "Investment Treaties and Investor-State Arbitration: Tools to Manage Political Risk in Emerging Markets," *EMPEA*, dated 15 October 2020, available here.

[2] *See id*. at 2 ("Although many investor-state arbitrations have related to natural resources or other tangible assets, recent tribunal decisions have made clear that investors in financial services, intellectual property, and other intangible assets are also protected.").

in recent years. Whether such instruments qualify as a protected "investment" will often turn on the specific language of the applicable treaty. Many investment treaties define the term broadly to encompass "every kind of asset," and a significant number make explicit reference to debt instruments such as "bonds, debentures, other debt instruments and loans." Previous investment-treaty tribunals have confirmed that loans, promissory notes, hedging instruments and sovereign bonds may constitute protected investments and, in certain cases, have awarded damages where host States have taken actions that have negatively impacted the value of those instruments.

The *Portigon* Decision

Continuing this line of jurisprudence, the majority in Portigon held that project finance loans and hedging instruments constitute a protected investment under the Energy Charter Treaty and the ICSID Convention.[3] The dispute is one of a number arising out of Spain's changes to its renewable energy incentive regime in 2013 and 2014.[4]

German financial services provider Portigon AG (formerly WestLB) had issued loans and interest rate swaps to investors in Spanish renewable energy projects and claimed that the regulatory changes negatively impacted the projects and their creditworthiness, which in turn diminished the value of Portigon AG's financing. The majority found that the loans and hedging instruments in question fell within the definition of "Investment" in the Energy Charter Treaty, which included "bonds and other debt of a company or business enterprise" and "claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment."

The Portigon decision is the latest in a series of international arbitration decisions, rendered under several different investment treaties, which have found that certain financial instruments enjoy treaty protection. This decision, and others before it, illustrates the valuable protections potentially available to private equity firms investing abroad, especially those investing in sectors and countries that are sensitive to adverse regulatory changes.

Top Three Practical Rules for Private Equity Firms

Private equity firms should keep in mind the availability and scope of international investment protection both when structuring cross-border financial investments and when assessing the possibility of bringing a claim in the face of harmful regulation, expropriation or other adverse State action. While coverage in any given case will turn on the specific facts and the language of the relevant investment treaty, general considerations include:

Rule #1: Structure your investment to benefit from treaty protection from the very outset: The investor's nationality and, sometimes, principal place of business will determine whether and what kind of treaty protections are available. If the transaction involves a chain of corporate entities with different places of incorporation, there might be multiple relevant investment treaties, each potentially protecting different entities in the corporate chain under slightly different terms

[3] The award is not yet publicly available but has been reported in the industry press. *See, e.g.*, L. Bohmer, "Breaking: Majority Arbitrators Uphold Jurisdiction Over Claims by Financial Institution Which Funded Renewable Energy Projects in Spain," dated 21 August 2020, available here.

[4] For more information on the Spanish renewable energy cases, *see Investment Treaties* at 2–3.

— or no viable right to international protection at all. Investors should seek legal advice early on to assess which investment treaties, if any, afford protection, and take this fact into account when structuring the transaction.

In particular, the scope of protected "investments" varies from treaty to treaty, especially with regard to debt instruments. It is therefore important to consider the language of each available treaty to confirm whether the instrument in question is likely to be covered.[5]

Rule #2: When you make changes to the investment structure, caution is warranted: If the transaction was originally structured without taking into account treaty protection, it may not be too late. It may be possible to create treaty protection through a minimal change to the structure of the transaction (e.g. by adding a wholly-owned subsidiary at some level in the corporate chain). However, in certain circumstances, subsequent corporate changes may unintentionally remove treaty protection and investors should seek legal advice before carrying out any such changes.

Rule #3: Speak and act carefully in interactions with the host State: Even if the transaction structure does not involve a direct contractual relationship between the investor and the host State, records of communications and interactions with the host State may turn out to be relevant evidence in an eventual investment treaty claim.

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Debevoise's International Dispute Resolution, Private Equity and Finance Groups are closely monitoring developments at the intersection of finance and international law.

[5] For a more detailed discussion on favorable jurisdictions for structuring investments and the types of treaty limitations that might be at issue, *see Investment Treaties* at 3.