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The State in Transition – Did the Questionable Privatisation Come to Haunt Bosnia?

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After three high-value infrastructure and energy projects cases at ICSID and the Permanent Court of Arbitration, Bosnia and Herzegovina ("BiH") is now facing a new US$40 million investment treaty claim. This time it involves the privatization of an insurance company – Krajina osiguranje a.d. Banja Luka, based in the Republic of Srpska (one of the two BiH's entities). Following failed negotiations for an amicable resolution with Republic of Srpska's Government, the Indian investors, Naveen Aggarwal and Neete Gupta and their New Delhi-based chemicals company Usha Industries, filed their request for UNCITRAL arbitration under the India-Bosnia 2006 BIT ("**BIT**"), seeking US$40 million for fraudulent acquisition of shares of Krajina osiguranje.

Relevant Facts

Initially, a majority state-owned entity, Krajina osiguranje was privatized in December 2015 via an international tender. Republic of Srpska's Ministry of Finance sought to attract private investors by issuing a prospectus in September 2015 that contained information on insurer's financial conditions and performance. Aggarwal and Gupta acquired just over 50% of the shares of Krajina for 4 million USD.

The investors claim that the prospectus contained multiple fraudulent misrepresentations and omissions, namely the quantum and value of specific properties owned, significant information on liability associated with pending litigation, and the value of shares that was significantly understated. They base their claim on the Trebinje Commercial Court's decision where the court found that Krajina's shares have been dramatically inflated above their true value and ordered the compensation of almost EUR 3 million to the investors. The investors further allege that they presented the judgment to the Bosnian officials who responded with a "series of punitive actions" designed to, among other things, suspend the rights of shareholders and to divert customers to rival insurers.

Notwithstanding the claim, since the investment was made in 2015, the investors were under serious supervision by Bosnian authorities, namely the Republic of Srpska's Insurance Agency, Security Commission, State Inspectorate and Ministry of Interior. The reason being the number of alleged unlawful misconducts in the management of Krajina that caused the insurance company to trade with high financial losses, questionable dismissals of workers, as well as the absence of the pay of its employees.

Dispute Resolution Clause

The UNCITRAL Arbitration Rules are silent on exhaustion of local remedies. Thus, the question of whether or not this principle applies is of a great importance. The exhaustion of local remedies, as interpreted in the *Elettronica Sicula S.p.A* case[1], could not be considered dispensed with unless such „dispensation" had been made explicitly.[2]

The alternative nature of the present BIT provision gives a menu of dispute settlement options to the investor (domestic authorities/conciliation or international arbitration). The similar wording can be found in the BIT Article 9(2)[3] in *Mytilineos v. Serbia and Montenegro* case, where the tribunal opined that the domestic court alternative in the fork-in-the-road clause obliges the investor to make a choice between pursuing the claim before a domestic court or international fora. The tribunal here concluded that due to its alternative nature, once the choice is made in favor of domestic remedies, international arbitration is no longer available. Thus, rather than a precondition, the initiation of local proceedings forfeits access to international arbitration.[4] Therefore, the main question for the tribunal certainly is whether initiating the proceedings before the local courts makes the same matter inadmissible before the international arbitration.

BIT Provisions and Host State's Measures

The investors claim that the State's measures breached the FET standard, expropriation provisions and obligation to provide MTF and national treatment.

Initially, the Insurance Agency passed a decision on 11 April 2016 suspending specific provisions of the Articles of Association that enabled the president and members of Managing Board to perform their roles. This entailed the right to dispose the assets on the bank accounts of the company, represent the company in legal transactions, or to authorize any third party to represent the company in any legal transaction. The Insurance Agency established the extraordinary administration in Krajina that then submitted a motion for a retrial to the High Commercial Court in Banja Luka.

The High Commercial Court in Banja Luka found that a number of illegalities in the investor's conduct initiated the decision of the Trebinje Court. *Inter alia*, the Court found that Mr Aggarwal, disregarding the decision of Insurance Agency, authorised the member of the Board to sign the Agency Agreement with company's attorney, to represent Krajina in the upcoming trial at the Trebinje Commercial Court, to admit the claim in full and renounce the right of appeal in the name of the company. Thus, the retrial was granted due to the violation of due process.

Looking at the BIT provisions, Article 3(2) briefly provides for *investments and returns of investments to be at all times accorded with fair and equitable treatment*. Since the BIT does not provide further elaboration on what would this practice entail, the claimant would in this instance usually argue that the State's conduct breached their legitimate expectation not just through the State's intervention in management of Krajina, but most certainly during the privatisation and inflation of value of its shares, and investment in general. On the other side, it is on the host State to prove that the measures in question were proportionate and necessary in order to protect the domestic legal system and that it did not involve a change of predictability and stability of domestic regulatory framework.

Article 5 BIT provides for exceptional cases where expropriation is allowed, prescribes the duty of due process and right to an independent judicial review and puts forth the right to a fair and equitable compensation.

Because of the Security Commission supervision, the investors were disowned of their rights as shareholders, since they failed to act in accordance with the relevant national legislation. The Commission found that the investors have acted in concert during the acquisition of Krajina's shares and ordered them to take over the company due to the joint venture of their shares. Since they failed to do so within the required timeframe, the management of Krajina was reinstated to the Investment and Development Bank of the Republic of Srpska.

Whether or not the Commission's decision was an act of expropriation or a valid regulatory act that is not subject to compensation will be on the host state to prove. In practice, States are given a wide margin of appreciation in these instances, both by the theory and practice. For instance, states usually argue that in order to suppress crime or as a sanction of violation of domestic law, the wrongdoing by the claimant necessitated such conduct. Thus, whether that be to prevent or prosecute monopolistic and anti-competitive practices, protect the rights of consumers, environment, and public health, or to regulate the conduct of corporations, the state has a right to intervene.

The same view was established in the case law, for instance in *Saluka v Czech Republic*, the tribunal found that "*States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.*"[5)] Thus, the tribunal would need to assess the nature of the measure whether it was a *bona fide* regulatory act, in accordance to the common and normal exercise of regulatory powers, whether it pursues a genuine public purpose, or whether it was implemented in a non-discriminatory manner.

Regarding the MFN and NT provisions, Article 4 BIT provides for a treatment that is not less favorable to that given to any third State (Art 4(1)) or its own investors (Art 4(2)) respectively. Whether or not the investors were under less favorable treatment is typically invoked in order to import a more favorable substantive protection, such as a broader definition of "investment", "compensation" or more favorable procedural conditions in order to bypass the need of exhaustion of local remedies. In this instance, the tribunal would need to determine whether such better treatment was indeed contained in a BIT with a third State, or if State's measures were to purposefully divert customers to rival insurers and thus provide them with a better treatment.

Conclusion

As it seems, the privatization of Krajina has caused more harm than good to the state that is still facing a significant financial and economic difficulties. The high-value cases like these are undoubtedly alarming and ask for a change and higher level of transparency during investment negotiations. On the other hand, one can wonder if the commencement of arbitration proceedings by the investors, demonstrated in an extreme way a notion of *forum shopping*, and with that undermined host state's normal exercise of regulatory power. Thus, the issue admissibility will certainly be the focus of tribunal's examination.

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References

?1 *Elettronica Sicula S.p.A.* (ELSI) (United States of America v. Italy), ICJ Report (1989)

?2 ibid.

?3 See, Agreement between the government of the Hellenic Republic and the Federal Government of the Federal Republic of Yugoslavia on the reciprocal promotion and protection of investment, 18 February 1998, available here ,art. 9(2)

?4 *Mytilineos Holdings SA v. the State Union of Serbia & Montenegro and the Republic of Serbia*, UNCITRAL, Partial Award on Jurisdiction, paras. 189, 204–208, 220–222 (Sept. 8, 2006), para 221

?5 *Saluka v. Czech Republic*, Partial Award, 17 March 2006, para. 255

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