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The Ongoing Lebanese Financial Crisis: Is There Potential For Investor-State Arbitration?

Michael Farchakh (Assistant Editor for the MENA Region) (Hadef & Partners) · Sunday, March 8th, 2020

Over the past few months anti-corruption protesters in Lebanon have taken to the streets calling for widespread reforms to the Lebanese economic and political system. This has caused considerable strain on the country's already frail economy. The first two weeks of the unrest saw a complete closure of banks with no possibility of making transfers or withdrawals. As the situation stabilised and the banks re-opened, restrictions were imposed on the withdrawal and transfer of funds for fear that a bank run would occur which could lead to a collapse of the Lebanese financial system. These restrictions have been described as *de facto* capital controls.

As a result, it has become nearly impossible to transfer money abroad or convert Lebanese Pounds into other currencies at the official rate, which has in turn affected the ability of businesses to import goods, something upon which the Lebanese economy heavily relies.

In light of these difficulties, investors may be keen to explore potential avenues of relief which would allow them to access their funds and be compensated for any ensuing damage to their business. The aim of this post is to explore whether investor-state arbitration would be an appropriate solution for these investors.

The Investment Protection Landscape in Lebanon

Lebanon is party to fifty Bilateral Investment Treaties (BIT), of which forty-two are in force, These are supplemented by two multilateral treaties: the OIC Agreement and the Arab Investment Agreement. Every one of these treaties provides various protections and guarantees for foreign investments and grants foreign investors access to some form of investor-state dispute resolution mechanism.

Free Transfer of Funds

All of Lebanon's investment treaties contain a "free transfer" provision which guarantees investors' rights to freely transfer funds relating to their investment in and out of Lebanon. Such funds may include the initial capital, the returns as well as the proceeds from the sale of an

investment. Typically, such provisions will also guarantee access to the foreign exchange market which allows the conversion of Lebanese Pounds into a freely convertible currency such as the US Dollar.

Free transfer provisions have rarely been relied upon in investment treaty arbitrations; however, there are at least two known occurrences of investors successfully invoking them: (i) the *Valores Mundiales v. Venezuela* case in which the tribunal condemned Venezuela for its failure to guarantee the investor unrestricted transfer of payments relating to their investment; and (ii) the *Pezold v. Zimbabwe* case in which Zimbabwe had restricted the investors from freely converting funds to US dollars.

A foreign investor in Lebanon may therefore have a valid claim under a free transfer provision which would allow them to have their funds unblocked. However, a claim under a free transfer provision would not address the losses that the investor may have suffered as a result of their funds being frozen for a period of time.

Fair and Equitable Treatment

Investors may be able to receive a more comprehensive recovery if they rely on the Fair and Equitable Treatment provision of the applicable treaty. In the case of the OIC Agreement which lacks an FET provision, investors may rely on the Most Favoured Nation clause to import FET protections from another treaty. The FET standard offers a wider scope of protection than the free transfer provision: in fact, the Tribunal in *Achmea v. Slovakia* found that the investor's free transfer claim was effectively subsumed by its FET claim.

A successful FET claim may allow an investor not only to recover the funds which are being blocked from transfer, but also to be awarded damages for incidental harms that have befallen their investment as a result of the restrictions. For instance, if an investor is no longer able to import certain goods that are essential to the operation of their business because of their inability to make payments to their suppliers, then it is notionally conceivable that Lebanon may be held liable for breach of the FET standard.

Full Protection and Security

All of Lebanon's investment treaties guarantee investments full protection and security. As the Tribunal in *CME v. Czechia* explained, a state's obligation to afford full protection and security arises not only out of the actions it takes but also out of its inaction.

Investors may therefore choose to rely on this standard to argue that the harm done to their investments was caused by the Lebanese state's idleness in (i) addressing the problems that caused the crisis in the first place, (ii) containing the protests once they erupted and/or (iii) controlling the actions subsequently taken by the private banks. This argument may be particularly apposite when it comes to the Lebanese government's failure to crack down on currency exchange offices which have been exacerbating the situation by illegally selling dollars at 30 to 60% above the official rate.

Bank Accounts as Investments: The *Ratione Materiae* Hurdle

Since the early 1990s Lebanese banks have been offering high interest rates, sometimes reaching 15% per annum, on savings accounts both in US Dollars and Lebanese Pounds. This has led many to deposit significant funds with Lebanese banks, enjoying steady returns over the years. In this context, it would be interesting to examine whether these bank accounts can themselves be considered investments protected under BIT provisions.

There is a good argument that an interest-bearing savings account would satisfy the *Salini* test as it would constitute (i) a contribution of assets (ii) over a period of time with (iii) an element of risk (given the longstanding political instability in Lebanon) and which arguably (iv) contributes to the host state's economy.

In *Czescik v. Cyprus*, the tribunal found that funds in a bank account could not be characterised as an investment, although importance was also given to the fact that the funds had only been transiting through a Cypriot bank account before reaching their final intended destination outside of Cyprus. In *Anderson v. Costa Rica*, however, the Tribunal embraced the wide definition of investment under the applicable treaty which included "any type of asset" in order to determine that interest-bearing deposits of funds constituted investments (although strictly speaking, these deposits were not bank account deposits).

Whether or not bank accounts would qualify as investments will therefore depend on the wording of the applicable treaty, the nature of the bank account and the intended purpose of the funds.

Dual Nationals as Investors: The *Ratione Personae* Hurdle

Lebanon has a significantly large expatriate and emigrant community, and it is likely that many of the people who possess bank accounts and other investments in the country will be dual nationals. Whether dual nationals may bring claims against Lebanon will therefore likely be a recurring issue.

Dual nationals are expressly barred from bringing such claims under the Canada-Lebanon BIT and the Iran-Lebanon BIT. And while no other treaties make similar prohibitions, dual nationals will be blocked from resorting to ICSID arbitration given that the ICSID Convention itself restricts dual nationals from bringing claims against either of their home states. However, all of Lebanon's treaties offer at least one alternative to ICSID arbitration, usually in the form of arbitration under the rules of UNCITRAL, the International Chamber of Commerce, the Stockholm Chamber of Commerce, or the Cairo Regional Centre for International Commercial Arbitration. In the treaty with Morocco, the Arab Investment Court is the proposed alternative and in the case of Syria it is the only non-domestic dispute resolution option.

That being said, even in a non-ICSID arbitration, dual national investors should still expect to face a jurisdictional challenge and should carefully consider the implications of recent case law on effective nationality.

The Unofficial Nature of the Restrictions: The Attribution Hurdle

For Lebanon to be found liable under an investment treaty, the breach of the treaty must be attributable to the Lebanese state. However, the restrictions that have been imposed were taken at the initiative of the banks themselves without any formal endorsement or measure by the government, parliament or central bank. The Lebanese state has been viewed as complicit in bringing about this situation, and there have been allegations that the measures were taken at the informal direction of the governor of the central bank who has been seeking to legitimise them. At present, however, the path to attribution is not straightforward.

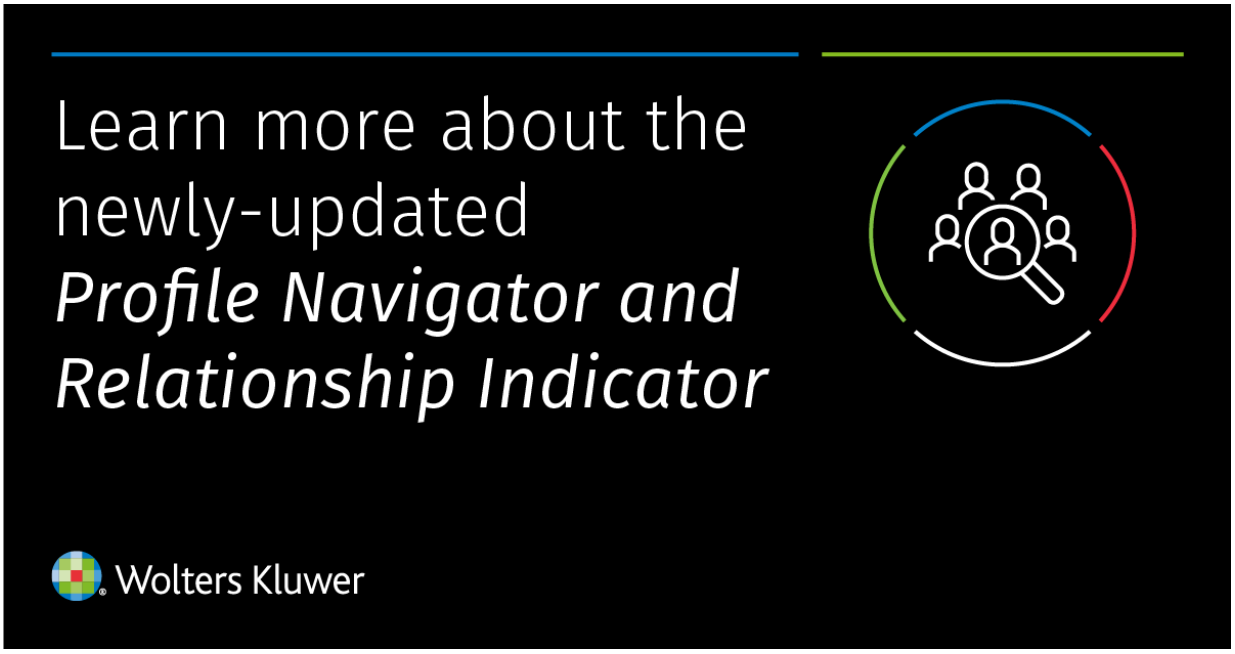
The attributability of a private bank's actions to the state has been explored on a number of previous occasions. The tribunal in *MNSS v. Montenegro* noted that although a private bank was under the supervision of the central bank, it was not under its control and therefore the actions of the private bank could not be attributable to Montenegro under Article 8 of the ILC Articles on State Responsibility. In *Marfin v. Cyprus*, the tribunal did not attribute the actions of a private bank to the respondent state despite the central bank having overall control over the bank, because the tribunal could not find any evidence that the controversial actions were taken at the instruction or direction of the respondent.

Conversely, in *Al Warraq v. Indonesia*, the tribunal found that Indonesia could be held liable for its inaction in the face of the banking crisis which had led to the collapse of a private bank. In the circumstances, however, the claimant was a shareholder in the collapsed bank, and the tribunal underlined that the central bank's duty of care was owed not to the bank's shareholders but to its depositors. There may, therefore, be scope to argue that despite not adopting any overt capital control measures, Lebanon would be liable for frustrating investors' legitimate expectations. Alternatively, the Lebanese government's failure to police the illegal measures taken by the banks may be construed as a breach of the full protection and security guarantee.

A Situation to Watch Out For

There have been talks of stronger measures to come such as haircuts, forced currency conversions and voluntary currency devaluation. If these materialise, they may lead to a flurry of expropriation claims.

Despite the obstacles that lie along the way and the fact that the situation has not fully crystallised, it appears that there is already room for investors to commence treaty arbitration and it will likely not be long before Lebanon starts receiving notices of dispute.



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