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Regime Change and State Contracts

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Overnight news reports of Libyan rebels liberating the capital Tripoli encourage many to hope that hostilities in the country are soon to end. At the same time, international diplomatic pressure on Syria's President Bashar al-Assad continues to mount with calls for his immediate resignation. For international companies with economic interests in these states, questions will nevertheless remain about the position of their investments over the coming weeks and months. What rights would such companies have following a change in the regime? What would happen if the country is divided? Equally, what will the position be if the current regime does not change after all?

Similar questions may arise in relation to investments in other countries undergoing a process of transition from one government to another or from one *form* of governance to another, be they in the Middle East or elsewhere. This client alert provides some insights into the rights of foreign investors into countries undergoing fundamental political and government changes.

What happens after regime change?

Just as the replacement of the CEO does not affect the legal identity and contractual obligations of a company, under the international-law doctrine of 'state continuity', changes in national Governments do not affect the legal identity or legal obligations of a state. The doctrine applies in the same manner even when a country undergoes changes from one *form* of government to another e.g. from a communist regime or dictatorship to democracy. Any state contracts or international law treaties and conventions entered into by a state remain in force as a matter of international law notwithstanding changes of government, however fundamental.

At first glance the doctrine represents 'good news' for foreign investors. Contracts or concessions entered into by a state or state organs under one regime will, as a matter of international law, remain in force under any subsequent government.

Nevertheless, it is common for new governments taking power following a significant political upheaval to seek, for political reasons, to distance themselves from the economic and commercial dealings of the previous regime. There are many examples of national laws being changed by new governments in order to nullify or revoke contracts and agreements entered by predecessor governments.

Were a state to take such steps following a regime change today, foreign investors who were treated unfairly, or required to give up contractual rights without adequate compensation, could seek redress under investment promotion and protection treaties, such as Bilateral Investment Treaties (or "BITs"), which typically provide foreign investors with:

- Guaranteed protections from discriminatory or arbitrary treatment by the host state;
- Compensation for losses caused by armed conflict or war;
- A right to compensation for breaches of contractual commitments; and
- A right to bring international law claims before impartial and independent international tribunals. Claims under BITs and similar treaties have proliferated in recent years as the international business and legal communities have come to accept such claims as offering effective remedies to foreign investors who have suffered ill treatment at the hands of sovereign states.

Foreign investors and new governments might, however, legitimately seek to renegotiate their contracts in the aftermath of months of disruption caused by armed struggle to take account of the effects of the conflict, provided of course that the process is consensual and freely accepted by both parties.

NB. notwithstanding any gains by rebel forces in Tripoli; foreign companies with interests in Libya should continue to carefully follow and abide by any trade sanctions laws that remain in force (see further details below).

What happens if a country breaks up into two or more parts?

Some commentators have suggested that following a regime change in Libya, the country could split into two or more sovereign states, either for a short period of time or permanently. The same could be true in other countries. There are a number of recent examples of states dividing into two or more sovereign entities, including most recently the secession of the Republic of South Sudan from the Republic of Sudan. The early 1990s saw the break up of the Soviet Union as well as Yugoslavia.

Where a state divides into two or more sovereign entities questions will necessarily arise as to whether the new (succeeding) state(s) should be bound by existing private law contracts and international law treaties entered into by the original (predecessor) state. After all, the new state would not be a party to such contracts or treaties. Where a state splits as a result of armed conflict - as opposed to peacefully by treaty as in the case of Sudan - the uncertainty is enhanced.

As far as commercial, private law contracts are concerned the position will depend on the facts and the provisions of the applicable national law. As a matter of international law, it is generally accepted that established (or acquired) private law rights under state contracts are unaffected by changes in national sovereignty at least until the newly formed state introduces new laws that state otherwise. Even without the introduction of new national laws, there will be some cases in which the doctrine of frustration or similar concepts could have the effect of bringing any continuing obligations to an end whether or not the law has been changed. In other cases, the performance of a state contract could be entirely unaffected by a territorial split elsewhere in the country.

The position with regard to international treaty obligations is different. The predecessor state will remain bound by any international treaties it has entered, but only insofar as they apply to the territories over which the predecessor state remains responsible under international law. Successor states are not, however, automatically bound by international treaties entered into by predecessor states. They will only be bound by pre-existing international conventions if they have expressly indicated that they wish to accept such treaty obligations and be bound by them. A bilateral treaty will only continue to have force if both parties express an intention to be bound.

What if there is no change?

While many analysts expect regime change to occur in Libya and Syria in the near future, it remains a distinct possibility that popular protest and uprisings might fail to bring about significant political change.

For as long as that remains the position, foreign investors should continue to carefully follow events and be wary of contravening any applicable trade sanctions (see our Client Alert 11-167, "Sanctions Targets," Client Alert 11-056, "Sanctions Against Libya" and Client Alert 11-027, "Turmoil in Egypt").

Investors who have already suffered loss or damage as a result of recent events should consider whether they might seek compensation under any relevant insurance policies (see our Client Alert 11-066, "Resource Nationalism - Managing the Risks"), or whether to bring claims for damages under existing contracts or indeed redress pursuant to any applicable BITs or similar international treaties.

Conclusion

Political transformation can create significant economic opportunities for international investors. However, foreign companies with interests in regions undergoing such change should be aware of the potential pitfalls as well as, where necessary, the availability of redress in international forums.

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This Client Alert was compiled up to and including August 2011.