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EUROPE

For Private Investors, Eastern Europe Can Be a Risky Play

Dispute-settlement courts are hearing more cases against 11 former Communist countries that joined the EU in 2004; wind farms in Poland generate lawsuits

Michael Polsky, CEO of Invenergy, speaks during the International Economic Forum of the Americas in Montreal in June 2018.
PHOTO: CHRISTINNE MUSCHI/BLOOMBERG NEWS

By Valentina Pop

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When U.S. energy company Invenergy LLC opened 11 wind farms in Poland in 2005, the country seemed like an investor's dream.

It had just joined the European Union, its economy was growing and its energy policy focused on EU goals of replacing coal with renewable sources.

Today, the Chicago-based company is in a legal battle with the Polish government over canceled contracts and other charges, claiming $671 million in damages. Invenergy officials say they regret investing in Poland and recommend others avoid the country.

"We will not invest another dollar in Poland until we have a fair resolution, and we would caution anyone considering investing in Poland," said Invenergy Chief Executive Michael Polsky.

Invenergy is still operating the wind farms, but they are generating lower-than-expected revenue after the government canceled several contracts. The company accuses Poland of "indirect expropriation" and unlawful termination of long-term commitments.

Joanna Kopcińska, a spokeswoman for the Polish government, declined to comment on the Invenergy dispute, citing confidentiality rules until a verdict is issued.

"Foreign investors form a vital part of the Polish economy and they do not seem to be eager to leave," she said, noting that in 2017 the country ranked first in the EU in terms of foreign direct investment.

Invenergy's case against Warsaw is one of dozens of suits private investors file annually in international dispute-settlement courts against foreign governments over decisions they allege undermine business plans. Increasingly, those suits are against governments in the 11 ex-communist countries that joined the EU after 2004, according to the United Nations Conference on Trade and Development.

Of 942 investor-state disputes world-wide since 1989, one in six was against the new EU members—and most were lodged after the countries joined in 2004. Foreign investors have claimed more than $10 billion in disputes with the governments amid a recent rise in nationalism and protectionist policies. The Czech Republic and Poland together account for nearly half of the region's cases, and each faces more investor lawsuits than Russia, China or India.

Globally, more than a third of cases are won by the states, slightly fewer than a third by investors. In the region, states win by a 2-1 ratio.

It wasn't supposed to turn out like this. Joining the EU was meant to guarantee foreign investors a stable political and legal environment. The U.S. and Western European countries in the 1990s had attached investment-protection clauses to bilateral treaties because companies were wary of ex-communist courts.

But investment disputes have picked up, particularly over the past decade, as East European politics shifted. Hungary, Poland and their neighbors have targeted foreign companies and gradually driven many out.

"The high number of cases against EU member states is a clear evidence of the backsliding of the rule-of-law level in those countries," said Nikos Lavranos, a Dutch lawyer for international investment disputes. "The EU institutions failed to effectively address this development even after 15 years of EU membership."

Eastern Europeans aren't alone in angering investors. Spain now ranks behind only Argentina world-wide, following an avalanche of cases over green-energy subsidies Madrid terminated in 2013 amid austerity measures.

But nowhere blossomed and faded like Europe's east. Swiss real-estate investor Sebastian Pawlowski discovered Prague 30 years ago and started advising German and Swiss companies entering the Czech Republic. He also established museums for Prague-born writer Franz Kafka and painter Alphonse Mucha.

"There used to be quite a few foreign companies doing property development in the 1990s in Prague," he said. "Now you won't see even one in the top 10.

Over those years, current Prime Minister Andrej Babiš, a former businessman ranked by Forbes magazine as richer than President Trump, has gained influence in sectors including agriculture, real estate and media.

Mr. Pawlowski said a 75-acre, 800-unit residential project he was developing outside Prague starting in 2007 suffered while developments nearby owned by Czechs, including Mr. Babis's firm, had no such hurdles. Mr. Pawlowski said his parcel was downgraded to agricultural land and the project was never able to start, despite initial investments and permits. He blames unjustified requests for payment from local authorities that he refused to pay.

Local district authorities said the requested payment was set to compensate for Prague taking too large a share from what the investor paid for the lot, according to court filings.

A disused military base his plot partly covers recently sat littered with broken furniture and the charred remains of a car.

In June 2015, Mr. Pawlowski formally notified the Czech government he would sue for $218 million over indirect expropriation at the International Centre for Settlement of Investment Disputes, a World Bank court that hears nearly half of these types of cases from Eastern Europe.

The Czech finance ministry, which handles investor disputes, had six months to address his grievances and avoid a lawsuit. The finance minister, now-President Babis, opted not to settle.

During that same period, Mr. Babis's firm, Imoba, was starting a similar residential project less than 3 miles from Mr. Pawlowski's land.

"One could speculate that it would be convenient for Imoba to have a competitor less offering flats and villas in the south of Prague," Mr. Pawlowksi said.

Czech government spokeswoman Jana Adamcova said the finance ministry had "decided in accordance with the applicable internal procedure that there are no sufficient grounds to settle the case."

She said the total number of investment disputes include an "unprecedented number of speculative disputes without a firm legal basis" pointing to the government's "success rate" in cases. According to Unctad, Prague won 15 of the 38 disputes filed against it since 1999.

Mr. Pawlowski sued the Czech Republic at the World Bank's dispute-settlement court in 2017. A verdict is pending.

Imoba's development is complete and other Czech-owned projects are going up near Mr. Pawlowski's land.

The U.S. Bureau of Economic and Business Affairs, which issues annual investment-climate reports by country, has warnings about the Czech Republic, Hungary, Romania and Bulgaria.

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In Poland, it flagged Warsaw's "controversial economic legislation" in sectors including renewable energy and noted that seven U.S. investors have sued Poland over the past decade.

"Investors have pointed to the outsized role of state-owned and state-controlled companies in the Polish economy as an impediment to dynamic growth," the report reads.

"The Polish government's lack of willingness to cooperate and denials of established facts are a major threat to the bedrocks of foreign investment and international law," Invenergy Chief Legal Officer Michael Blazer said.

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