



Categorizing Foreign Direct Investment Protection Mechanisms

by Dr Wael Saghir

I. Introduction:

With many investors and multinational corporations (MNCs) looking to explore new markets, the need to properly understand the limits of protection available to them becomes of paramount importance. Since MNCs and investors might experience a number of difficulties while venturing in states that offer minimal property rights protection to foreign investors, the need to understand what kind of protection is available to them prior to the investment phase and after the investment takes place in the host state is something that they are increasingly looking into.

Classically, investors and MNCs, while venturing overseas, may experience a number of investment-related-risks. These have mainly been categorised as political, commercial and financial risks.¹ Others suggested a more comprehensive approach to identifying the various risks associated with foreign direct investment and suggested differentiating between Political Risk, Financial Risk, Commercial Risk, Political Financial Risk and between Political Commercial Risk.²

However these risks may be categorised or referred to, actions constituting these risks are what concern foreign investors and MNCs the most. From there, investors' and multinationals' need to understand how they can be protected arises.

Foreign direct investors and multinationals are constantly looking for various means that would help them reduce their risk exposure in a given host state. That said, it is necessary that investors and MNCs understand when these risk reduction mechanisms take place. As such, it is important to distinguish between *pre-investment protection mechanisms* and *post-investment protection mechanisms*.³

II. Pre-Investment Protection

Investors and MNCs, prior to engaging in any international business venture, conduct several field studies to understand the nature of the risks they may encounter. While doing so, they also analyse all measures of protection available at their disposal.

These MNCs and investors normally try to understand the nature of risks they could face in any prospective host state and attempt to find means that allow them to hedge such risks.

¹ ER Yescombe, *Principles of Project Finance* (2nd edn, Elsevier Inc. 2014) pp 197 - 198.

ER Yescombe refers to Financial Risks as Micro-economic Risk. See: ER Yescombe, *Principles of Project Finance* (1st edn, Elsevier Science. 2002) pp 183 - 199

² Wael Saghir, *Foreign Direct Investment Risks and Export Credit Agencies: A Practitioner's Guide* (Wildy, Simmonds and Hill 2018) p 72.

³ The distinction between pre-investment protection and post-investment protection was first suggested in the *Foreign Direct Investment Risks and Export Credit Agencies: A Practitioner's Guide*. See: Saghir (n 2) at p 46.

From here, multinationals and investors look for means to protect them against investment risks prior to investing in the host state. Such measures are known as *pre-investment protection*.⁴ As such, *pre-investment protection* includes a number of investment protection mechanisms, other than those awarded to investors in customary international law, ranging from home state's unilateral initiative to multilateral initiatives by home and host states.

One of the main measures of protection of foreign investors' and MNCs' property rights are those undertaken by the home state. A number of home states have taken the initiative in preparing studies aimed at their national investors who are considering investing overseas. For example, the United Kingdom and the United States of America have both taken such measure where they periodically publish studies about the investment environment in prospective host states. The UK, for instance, in a study prepared in 2016, advised its investors about the business environment in China where it discussed risks associated with doing business in China, the process of setting up a company there, transferring money from China and, most importantly, the legal considerations for doing business in China among other considerations and recommendations.⁵

The United Kingdom was not alone in taking such measure to warn its investors of potential risks or other investment-related considerations. The United States of America followed the footsteps of the UK and periodically publishes reports about other states' investment environment in order to inform US investors about the possible risks associated with entering these markets and to provide them with guidance and a general understanding of the investment destination of their choice.⁶

For example, the United States published reports about the business and investment environment in Taiwan where it included information on business and legislative risks, market barriers and on the limits of foreign investors among other information it made available to investors and MNCs.⁷

Similarly, but on a lesser extent, Australia publishes information about various destinations to inform its investors on the prospective host states' market points of strengths and weaknesses and to inform Australian investors about the economic relations present with these prospective investment destinations. For example, Australia published an overview about India where it discussed the political and economic conditions of India and highlighted trade and investment agreements put in place between the two states.⁸

Nevertheless, these unilateral movements were accompanied by bilateral and multilateral movements which had its roots in customary international law. These bilateral and multilateral movements took two forms with the first being Investment Treaties and the second being Investment Insurance.

⁴ Saghir (n 2) at p 189

⁵ These can be found at: <<https://www.gov.uk/guidance/exporting-to-china>> Last accessed on the 16th of June 2018.

⁶ The full list of countries can be found at: <<https://www.state.gov/misc/list/index.htm>> Last accessed on the 16th of June 2018.

⁷ Information can be found at: <<https://www.state.gov/e/eb/rls/othr/ics/2017/eap/269854.htm>> Last accessed on the 16th of June 2018.

⁸ Information can be found at: <<http://dfat.gov.au/geo/india/Pages/india-country-brief.aspx>> Last accessed on the 16th of June 2018.

With respect to International Investment Treaties (IIAs) these treaties included special clauses that had their roots embedded in customary international law. Investment treaties like Bilateral Investment Treaties (BITs), which are signed and negotiated between two states, and Multilateral Investment Treaties (MITs), which are signed and negotiated between three or more states, include numerous provisions that are believed to facilitate, promote and, at the same time, enhance the protection awarded to foreign investors.⁹ Although most of the measures provided within IIAs are, in general, considered as *pre-investment protection mechanisms*, some may, nevertheless, be considered as *post-investment protection mechanisms*.

Some of the clauses included in these agreements, like the national treatment, most favoured nation, fair and equitable treatment and non-discriminatory measures¹⁰ are all meant to present investors and MNCs with better and more general protection against political risk especially against expropriation.¹¹

The Most Favoured Nation Clause, or MFN, allows investors and MNCs of signatory states to be favoured over investors and MNCs of other states through awarding them a treatment no less favourable than that awarded to investors in other treaties.¹²

National Treatment, which was originally derived from the Calvo Doctrine,¹³ under BITs, asks for investors of signatory states to be treated in a way that is no less favourable than that awarded to national investors of these states.¹⁴ While Fair and Equitable Treatment, on the other hand, unlike the previous two clauses, differs from one treatment to another and, as such, could be subject to varying interpretations.¹⁵

⁹ Karl P Sauvant and Lisa E Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009) p 253.

And;

Herman J.R Walker, 'Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice' (1956) 5 *The American Journal of Comparative Law*, p 229.

And;

Kenneth J Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (Oxford University Press 2010) p 4.

¹⁰ Jarrod Wong, 'Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes' (2006) 14 *George Mason Law Review*, p 138.

And;

Susan Rose-Ackerman and Jennifer Tobin, 'Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties', Yale Law and Economics Research Paper No 293 (Social Science Research Network 5 May 2005) p 10

¹¹ Sauvant and Sachs (n 9) at pp 253-254.

¹² OECD (2004), "Most-Favoured-Nation Treatment in International Investment Law", *OECD Working Papers on International Investment*, 2004/02, OECD Publishing, p 2.

Found at: <<http://dx.doi.org/10.1787/518757021651>> Last accessed on the 16th of June 2018

¹³ The Calvo Doctrine was introduced in 1868 by an Argentinian Jurist, Carlos Calvo, who requested offering foreign investors a national treatment and, in return, foreign investors would waive their right to resort to Diplomatic Protection.

See:

R. Doak Bishop, James Crawford, and William Michael Reisman (eds), *Foreign Investment Disputes: Cases, Materials and Commentary* (Kluwer Law International 2005) p 3.

¹⁴ Rudolf Dolzer, 'Making the Most of International Investment Agreements: A Common Agenda', (Symposium Co-organised by ICSID OECD and UNCTAD, 12 December 2005) p 1.

Found at: <<https://www.oecd.org/investment/internationalinvestmentagreements/36055356.pdf>> Last Accessed on the 16th of June 2018.

¹⁵ OECD (2004), "Fair and Equitable Treatment Standard in International Investment Law", *OECD Working Papers on International Investment*, 2004/03, OECD Publishing. p 2. Found at: <<http://dx.doi.org/10.1787/675702255435>> Last accessed on the 17th of June 2018.

N.B. Fair and Equitable treatment was first suggested in the Havana Charter of 1948.

See:

Havana Convention for International Trade [1948], Article 11(2)a.i.

Another important clause offering protection to investors and multinationals present in BITs is the Umbrella Clause in which signatory states take it upon themselves to honour their agreements with investors or multinationals.¹⁶

In addition to IIAs, many capital exporting states took a unilateral initiative to offer their investors an extra layer of protection against, mainly political related risks, while investing in developing states, in the form of government backed insurance through Export Credit Agencies (ECAs) and Export Import Banks (Ex-Im Banks).¹⁷ This unilateral movement was accompanied by a multilateral movement by a number of states who decided to offer insurance through a multilateral agency referred to as the Multilateral Investment Guarantee Agency (MIGA).¹⁸

These agencies, in addition to insurance companies, offer insurance against a number of risks that investors and multinationals may encounter while investing overseas. The way these agencies work is as insurers of last resort meaning that investors and multinationals are expected to seek insurance companies' support in the first place and should they fail to find the support they require through these companies, they may seek the support of national insurance programs.¹⁹ Then, in case MNCs or investors fail to find the support they require through national insurance programmes, only then, they could resort to MIGA.²⁰

The difference between insurance programmes offered by insurance companies, on the one hand, and those of ECAs, Ex-Im Banks and MIGA, on the other hand, is that the list of political related risks covered by ECAs, EX-IM Banks and MIGA are more comprehensive than those covered by insurance companies.²¹

Traditionally and prior to engaging in any commercial activity in a given state, investors and MNCs will seek to insure their upcoming investment against a number of risks that they foresee. As such, this measure, though its effects will only take place after an investment is made and after the insured risk is encountered, it is, nevertheless, a measure that the investor or multinational seek prior to their investment and therefore, it is considered a *pre-investment protection mechanism*.

Another mean of *pre-investment protection* that many investors and MNCs consider prior to investing in certain host states is partnering with a local host state investor who may have connections with host state officials or who understands the nature of doing business within the host state. In taking such route, MNCs and investors believe they would reduce their risk exposure since the host state is less likely to take investment-restrictive measures against its national investors. This was, for example,

¹⁶ Jarrod Wong, 'Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes' (2006) 14 *George Mason Law Review*, p 136.

¹⁷ Jason Chuah, 'Export Credit and Credit Guarantee Institutions - Balancing Values in the Regulatory Environment' (Social Science Research Network 2010) p 155.

¹⁸ R. Doak Bishop, James Crawford, and William Michael Reisman, *Foreign Investment Disputes: Cases, Materials and Commentary* (Kluwer Law International 2005) p 6.

¹⁹ Kathryn Gordon, *Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development* (Organization for Economic Co-operation and Development (OECD) 2008) p 104.

²⁰ *Approached to Enterprise Risk Management* (Bloomsbury 2010) p 146.

²¹ Saghir (n 2) at p 275.

the preferred entry-into-market mode for Starbucks in China and, most recently, a strategic plan for growth for McDonalds in China as well.²²

Although, on the other end of the JV spectrum lies a number of associated risks, nevertheless, in this paper, JVs were looked at from an advantageous point of view and as a mean to counter and limit investment associated risks prior to engaging in any form of investment in a given host state.

As such, it can be concluded that the *pre-investment protection* phase includes, in the first place, recommendations by the home state, special treatment awarded to investors and MNCs found in IIAs and in International Treaties. Additionally, this phase includes seeking to partner with local host state investors and looking for insurance provided by insurance companies and/or insurance provided by national and regional insurance programmes sponsored by the home state.

In addition to these *pre-investment protection* measures, there are other mechanisms that take place after an investment is made and after the investor's property is threatened.

III. Post-Investment Protection

Foreign investors and multinationals may be able to protect their property rights after their investment is realised in the host state and once their right to enjoy and benefit from their property is threatened by the latter.

In such instance, i.e. once investors' property rights are threatened, there are *post-investment protection mechanisms* available to these investors and multinationals that would allow them to retrieve their property or grant them an adequate compensation for the losses they may have incurred as a result of such breach by the host state.

As a first measure, investors and multinationals can seek to impose special clauses in IIAs and BITs that their home states signed with the host state. These BITs, as mentioned earlier, include clauses that may be considered as a *pre-investment protection mechanisms*. Nevertheless, it also entails numerous clauses that may be considered as *post-investment mechanisms*.

Perhaps one of the prominent features of BITs is the Expropriation clause in which signatory states takes it upon themselves to regulate, closely, instances in which they could expropriate investors' properties. In such clause, signatory states agree to pay adequate, fair and prompt compensation to the property right owner.²³

Such measure is of high importance in developing states that have history in claiming investors' and multinationals' property rights for public purpose. States like Venezuela, Ecuador and Egypt all have history in expropriating investors' properties.

²² For information about Starbucks, please see the news article on CBS News: Starbucks Coffee is China-Bound, CBS News (18 September 1998 at 11:47 am) Found at: <<https://www.cbsnews.com/news/starbucks-coffee-is-china-bound/>> Last accessed on the 19th of June 2018. For information about McDonalds, please see the News Release published on January 9th, 2017 by the Carlyle Group: <<https://www.carlyle.com/media-room/news-release-archive/citic-limited-citic-capital-carlyle-group-and-mcdonald's-form>> Last accessed on the 19th of June 2018.

²³ Ibrahim F Shihata, *Legal Treatment of Foreign Investment* (Martinus Nijhoff Publishers 1993) p 257.

One of the most prominent examples concerning Venezuela was that taking place in 2006 where Exxon Mobile, an oil company, had its assets seized by the government of Venezuela.²⁴ Similarly, Ecuador had put its hands on a number of oilfields of which Burlington Oriente had been exploiting for oil.²⁵ Lastly, Egypt also had history in expropriating foreign investors' properties where it had taken possession, by force, over two properties owned by the British hotel company Wena Hotels Ltd.²⁶

This Expropriation clause comes in hand with Arbitration clauses which is considered as a measure of safeguarding investors' and multinationals' property rights and considered, as well, as a disciplinary measure against host state's actions.²⁷

Arbitration clause, in investment treaties, clearly defines the competent body in charge of settling disputes between states and investors. Many BITs suggest resorting to the International Centre for Settlement of Investment Dispute (ICSID).²⁸

This Centre was established in 1965 for the sole purpose of settling investment related disputes.²⁹ It settles disputes arising between foreign investors and host states and also settles disputes arising in connection with an investment between two states.³⁰ Notably, it settled disputes arising between Venezuela and Exxon Mobile, Egypt and Wena Hotels Ltd and between Ecuador and Burlington Oriente to name a few.³¹

In addition to these previous measures present within BITs, a third mechanism is also available to investors and MNCs which would offer them protection after their investment is realised. This last mechanism comes in the form of a guarantee by the host state that it will extend its special treatment awarded to investors under an investment treaty for a specified period of time. The only condition to extend such treatment is that the investor should have made an investment while the investment treaty was in force. This third mechanism is known as the Severability Clause or the Sunset Clause.

A sunset clause, therefore, is one in which a host state guarantees to extend the special treatment awarded to foreign investors under an investment treaty for a specified period of time, normally between 5 and 20 years, after the said treaty has expired or after its termination. For example, the UK and Lebanon BIT cited a 10-year-severability term whereas the BIT between the UK and

²⁴ Chris Hajzler, 'Expropriation of Foreign Direct Investments: Sectorial Patterns from 1993 to 2006', (September 2010) University of Otago Discussion Paper No. 1011, p 19.

²⁵ Information can be found at: <<https://www.iisd.org/itn/2017/09/26/icsid-tribunal-awards-roughly-usd380-million-compensation-illegal-expropriation-ecuador-matthew-levine/>> Last accessed on the 17th of June 2018.

²⁶ *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No. ARB/98/4 [Awarded 2000] p 2.

²⁷ Sauvant and Sachs (n 9) p 131.

²⁸ The BIT between Spain and the Philippines for example resorted to ICSID. See; Agreement between the Italian Republic and the Lebanese Republic on the Promotion and Reciprocal Protection of Investments (1997). Article 7(2)b. And; Agreement between the Kingdom of Spain and the Republic of Philippines on the Promotion and Reciprocal Protection of Investments (1993) Article 9(2)b. (Translated from Spanish).

²⁹ T.J Girerson Weiler (ed), *Investment Treaty Arbitration and International Law* (JurisNet 2008) p 61

³⁰ Weiler (n 24) at pp 85-86.

³¹ For more information about these cases see; Mobil Corporation, Venezuela Holdings, B.V., et al. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27.

And; Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5.

And; *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No. ARB/98/4.

Argentina insisted on a 15-year period.³² The UK and Bahrain BIT on the other hand asked for the application a 20-year-svereability term.³³

The importance of such clause comes in times when a given host state decides not to renew a specific investment agreement for another term or in case the host state decides to withdraw and terminate a certain investment agreement.

Investment agreements and international arbitration are not the only means of *post-investment protection* measures available to foreign investors. Foreign investors may, finally, resort to their host state for protection through what is known as Diplomatic Espousal.

Diplomatic Protection or Diplomatic Espousal is a mean of organisation between home and host states to protect foreign investors where investors' home state invokes diplomatic protection in order to repatriate investors for any losses that they suffered from due to the host state's misconduct.³⁴ This exact action was the basis of the Calvo Doctrine in which the Argentinian jurist suggested granting foreign investors a national treatment in return of the latter waiving their right to Diplomatic Protection.³⁵

Historically, Diplomatic Espousal included the use of force but only after local remedies were exhausted although this type of intervention moved towards a diplomatic form through resorting to mixed claims commissions to settle any disputes between investors and host state.³⁶ Nowadays, diplomatic protection comes in the form of peaceful means to stele disputes between investors and the host state.³⁷

As such, it could be concluded that *post-investment protection* mechanisms include certain clauses found within investment treaties, arbitration and dispute settlement and finally it includes diplomatic espousal.

IV. Conclusion

In the age of globalisation and cross border investments, multinationals and investors who are eager to explore new untapped markets to maximize their profit are constantly concerned about the

³² For the UK and Lebanon BIT see; Agreement Between the Government of the United Kingdom and Northern Ireland and the Government of the Lebanese Republic for the Promotion and Protection of Investments; Signed in 1999 and put in force in 2001. Article 14(2). For the UK and Argentina BIT see;

Agreement Between the Government of the United Kingdom and Northern Ireland and the Government of the Republic of Argentina the Promotion and Protection of Investments; Signed in 1990. Article 14

³³ Agreement Between the Government of the United Kingdom and Northern Ireland and the Government of the State of Bahrain for the Promotion and Protection of Investments; Signed in 1991. Article 14.

³⁴ Bishop, Crawford and Reisman (*n 18*) at p 3.

And;

Daniel de Andrade Levy, Ana Gerdau de Borja and Adriana Noemi Pucci (eds), *Investment Protection in Brazil* (Wolters Kluwer, Law & Business 2014) p 73

³⁵ Christopher K Dalrymple, 'Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause' (1996) 29 Cornell International Law Journal, p 163.

³⁶ Chin Leng Lim, Jean Ho, Martins Paporinskis, *International Investment Law and Arbitration: Commentary, Award and other Materials*, (Cambridge University Press 2018) pp 4-10.

³⁷ Draft articles on Diplomatic Protection [2006] *Official Records of the General Assembly, Sixty-first Session, Supplement No. 10 (A/61/10)*. Part 1 Art. 1.

various risks they may encounter while venturing abroad. As such, they are keen on understanding how they could protect themselves against these risks.

For that, it is important to distinguish between the protection investors and multinationals may benefit from while investing abroad before realisation of said investment and after the investment is made.

Doing so will give investors and multinationals a clearer view of the different protection mechanisms and the actual time these mechanisms come in place to provide investors and multinationals with a comprehensive view on what and when to resort to a certain measure.

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