OXFORD INTERNATIONAL ARBITRATION SERIES

INTERNATIONAL INVESTMENT, POLITICAL RISK, AND DISPUTE RESOLUTION

A Practitioner's Guide

SECOND EDITION

NOAH RUBINS
N. STEPHAN KINSELLA
THOMAS-NEKTARIOS PAPANASTASIOU

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The aim of this series is to publish works of quality and originality on specific issues in international commercial and investment arbitration. The series aims to provide a forum for the exploration of important emerging issues and those issues not adequately dealt with in leading works. It should be of interest to both practitioners and scholarly lawyers.

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SERIES EDITOR'S PREFACE

This series of monographs is dedicated to specific issues in international arbitration law and practice, and gives authors the opportunity and the challenge of a more in-depth treatment than is possible in leading generalist works. It also provides an international forum for the profound exploration of important practical and theoretical matters and will further the development of arbitration as a self-luminous academic discipline and major international legal practice area.

This twentieth book in the series is a second, fully updated and expanded edition of a successful book on international investment, political risk, and dispute resolution. The issue of political risk and its impact on dispute resolution is pervasive but has been in the limelight in recent years given, for example, the crisis in Venezuela, the annexation of Crimea by the Russian Federation, and several other events of political risk in other parts of the world. This new monograph for the series by Noah Rubins, Stephan Kinsella, and Thomas-Nektarios Papanastasiou aims to be the undisputed reference book on the topic. Indeed, while some articles exist on the topic this is the main book addressing all these critical issues.

International Investment is constantly exposed to legal and political risk. Political risk has been the source of increased concern for international investors: regime change, political instability, and civil unrest can and do have adverse impact on foreign investments. Both governments and the international business community wish to have clarity as to the relevant risk and how such risk may be insured. Since the first edition of this book in 2005, a great deal has happened: political risk has increased rather than diminished and although the original structure has been maintained, one chapter has been added and all other chapters have been significantly updated and amended.

The book is organised in three parts.

Part I, provides the context and foundations of the monograph: chapter 1 explores the concept and ontology of political risk, chapter 2 discusses how transactions may be arranged (structure of contracts, contract drafting and key clauses), to minimize political risk and chapter 3 looks at available investment insurance (OPIC, national insurance programmes, MIGA and available private insurance).

Part II is one of the two main parts of the monograph and is dedicated to the international law framework of investment protection and political risk. Chapter 4 focuses on state responsibility and remedies under customary international law (and also covers the issue of jurisdictional immunity of states), chapter 5 is dedicated to the history and evolution of customary international law of expropriation and investment protection while chapter 6 discusses the substantive law of contemporary international investment protection.

Part III addresses investment disputes, human rights, and political risk. Chapter 7 explores the establishment of arbitral jurisdiction, chapter 8 looks at arbitration procedure (including pursuant to ICSID and UNCITRAL Rules), and chapter 9 is dedicated to the mediation and conciliation of investment disputes. Chapter 10 focuses on the intervention of states in investment disputes (including a section on economic sanctions). Finally, chapter 11 explores the interaction between international investment law and human rights. Amongst the useful appendices there is an OPIC Contract of Insurance and a Sample Private Contract.

This is a substantially updated and enhanced version of the 2005 first edition of this book and contains a wealth of research and a systematic, balanced, and comprehensive analysis of all major issues associated with the topic. It is insightful and very relevant to practice and a most welcome addition to the series.

LM
London 7 June 2019

PREFACE

The first edition of our book *International Investment, Political Risk, and Dispute Resolution: A Practitioner's Guide* was warmly received by practitioners and scholars on its release well over a decade ago. But much has happened in law and international arbitral practice since the first edition. For this reason, a third co-author has been enlisted to contribute to this second edition.

Given the positive response and the increasing importance of the subject matter, we have long felt that there was a need to maintain the book as a current reference work by integrating contemporary issues related to international investment and political risk.

Political risk—the risk that a host government will interfere with the property rights of a foreign investor—remains a topic increasingly central to strategic discussions within both governments and the international business community. Our purpose is to explore the multi-layered legal framework for the protection of foreign investment against political risk, analyzing some of the key issues, such as structuring transactions to minimize political risk, political risk insurance, State responsibility, treaties protecting foreign investment and human rights, and international arbitration between States and investors.

Since the previous edition was released in 2005, far more attention has been paid to some of these issues, in particular investor–State arbitration, as well as other current topics such as the interaction between international investment law and human rights. The original structure of this book remains unaffected. The present volume provides updated and expanded coverage of the issues addressed in the 2005 edition.

All chapters have been revised, updated, and some significantly reorganized, given the number of new arbitration awards that have come to light and the massive volume of commentary on the subject of international investment arbitration since the first edition. Dr. Papanastasiou's input was critical to the update. His additions to the text also expanded upon the original with entirely new sections and brought new material and commentary. We have taken into account the latest theoretical approaches to foreign investment protection and the most intellectually challenging awards issued in the intervening decade, as well as the most recent practical guidance on the procedural recourse available to investors who face political risks. Our third co-author's contribution was also decisive in adding a new chapter (Chapter 11), which explores the interaction between international investment law and human rights, and considers whether, as between alternate fora, the result is complementary or divergent.

Finally, this book is addressed to a wide audience, and is written to appeal to lawyers and non-lawyers alike. It is suitable as a primer for non-specialist practitioners (attorneys, in-house and outside counsel for corporations and investors) seeking to familiarize themselves with international law pertaining to political risk. While appropriate for practitioner use, this book is also suitable for undergraduate students or for graduates (as a textbook for one or two semesters) who intend to specialize in international investment law.

Before concluding, we would like to thank Emmanuel Giakoumakis, Associate Legal Officer to the President of the International Court of Justice, for his research assistance in reviewing recent developments in the work of investment treaty tribunals.

In this guide, we hope to provide our readers with the tools necessary to understand the international law of investment and its relationship to political risk. If we have succeeded in our task, the reader will be better equipped to understand political risks associated with foreign investments and how they are managed, negotiated, and safeguarded.

Noah Rubins
N. Stephan Kinsella
Thomas-Nektarios Papanastasiou
January 2019

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INTRODUCTION

The twentieth century witnessed two important economic counter-currents affecting the international investment community. On the one hand, institutionalized respect for individual rights has spread swiftly across many parts of the globe. On the other hand, collectivist ideologies, political clashes, and misunderstandings between the developing and developed world[1] have led at times to massive nationalizations and confiscations of the property of investors from capital-exporting States.

Most of these nationalizations and confiscations were takings of property invested in developing states in the form of so-called "foreign direct investment" (FDI). Foreign direct investment refers to direct or indirect control of either assets or an enterprise in a foreign country through ownership of a substantial portion of the assets or enterprise.[2] It is "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective voice in the management of the enterprise."[3] One commentator defined FDI in the following terms:

> [Foreign direct investment] may best be defined as the creation, acquisition or endowment in the host country of enterprises, either incorporated as branches, subsidiaries, or associate companies, or in the form of unincorporated enterprises or joint ventures. The desired result is to acquire a lasting interest, with powers of management and control, where the investor's return depends upon the performance of the enterprise. [Foreign direct investment] flows include all funds provided by the investor, specifically, equity capital, reinvested earnings, and net borrowings.

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[1] Developing States have often accused multinational corporations of adopting overly capital-intensive production techniques and making insufficient transfers of technology. Klaus P. Berger, *The New Multilateral Investment Guaranty Agency Globalizing the Investment Insurance Approach towards Development*, 15 Syr. J. Int'l L. & Com. 13, 31 (1988).

[2] Thomas L. Brewer, *International Investment Dispute Settlement Procedures: The Evolving Regime for Foreign Direct Investment*, 26 L. & Pol'y. Int'l Bus. 633, 634 (1995); *see also* Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 Colum. J. Transnat'l L. 1 (1995). Different countries use different threshold levels of ownership, usually between 10 and 25 percent, to distinguish FDI from so-called "portfolio investment." Brewer, *id.* at n.2.

[3] International Monetary Fund, Balance of Payments Manual, para. 408 at 136 (4th ed. 1977). Thus, "[w]ith respect to foreign direct investment, a foreign investor retains at least part of the ownership and control, unlike [official development assistance] and private bank lending where the business is owned and controlled by local companies or entrepreneurs." Berger, *supra* note 1, at 17.

> Equity investment that does not meet this standard constitutes portfolio investment which is placed through the capital markets without entrepreneurial commitment and merely for the sake of capital yield.[4]

FDI as a mode of economic activity offers benefits for both investors and host States that cannot be gleaned from portfolio investment. From the private party's standpoint, FDI provides a platform for implementing improvements, seizing on potential efficiency and synergy gains, and otherwise gaining advantage from the investor's own initiative, innovation, and vision. From the government's perspective, FDI is a potential engine for development, as the foreigner employs and trains local personnel, indirectly encourages secondary service providers and producers of goods, pays taxes, and—in some cases—leaves behind valuable know-how.[5]

But FDI's benefits for all cannot come without concomitant risks. In order to obtain the necessary control over local operations, the investor must "invest himself," placing his money, equipment, personnel, and day-to-day operations within the sphere of the host State's local law, customs, and political vagaries.[6] For developing state governments, meanwhile, the political pressure to extract additional benefits for local constituents grows as the foreign-owned enterprise prospers. Particularly in times of social and economic instability, host governments may be tempted to redistribute some of the foreigner's property to achieve political gain. Such a shift of property may take any number of forms, from direct nationalization by fiat to increases in taxes, fees, or investment requirements.

Furthermore, the salubrious effect of FDI on the economy of developing countries is hardly undisputed.[7] Some argue that freedom of investment equals a

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[4] Berger, *supra* note 1, at 17 (references omitted).

[5] *See generally* UNCTAD/UNEP, Foreign Direct Investment and the Promotion of Sustainable Human Development (1999); J.P. Agarwal, *Effect of Foreign Direct Investment on Employment in Home Countries*, 6 Transnat'l Corporations 1 (1997); *see also* Running into the Sand, Why a Failure at the Cancun Trade Talks Threatens the World's Poorest People, OXFAM Briefing Paper No. 53 (Sept. 2, 2003), at 33, available at https://policy-practice.oxfam.org.uk/publications/running-into-the-sand-why-failure-at-the-cancun-trade-talks-threatens-the-world-114588 (FDI can play a crucial role in development by transferring capital, technology, and skills into developing countries; UNCTAD research indicates that the number of regulatory changes in the domestic foreign investment regulations of the relevant countries during the relevant period was over 1,300, 95 percent of which were aimed at facilitating foreign investment) (citing UNCTAD, World Investment Report, Geneva (2002)). Nevertheless, considering the impact of FDI on host States' economic development, various conflicting economic theories have been formulated. *See* M. Sornarajah, The International Law on Foreign Investment 47–60 (3d ed. 2010).

[6] The distinction between "investing" and "investing oneself" was best articulated by Professors Carreau and Juillard in Dominique Carreau & Patrick Juillard, Droit International Economique 387 (2003) ("Il faut non seulement que l'investisseur investisse, mais encore qu'il s'investisse").

[7] However, there is a growing demand for reformulated investment policies that would prioritize sustainable development for host States, sanction of environmental abuses, the protection of human rights and labor rights, and the like. Moreover, according to empirical studies, there is no consensus as to whether FDI inflows have uniformly had a positive impact on GDP growth, especially for developing economies; *see e.g.* Laza Kekic, *To What Extent has FDI Benefited the Transition*

license for multinational corporations to pillage the assets of poorer countries, buying resources for less than their true value and expatriating them to the home country.[8] At the very least, the influx of capital does not necessarily mean that the profits gained from that investment will remain in the developing host country. Between 1965 and 1986, "net transfers" on FDI, meaning the flow of investment adjusted for the repatriation of profits, was either negative or only slightly positive.[9] Therefore, some have argued that an increase in direct investment into a less-developed country may not necessarily provide substantial support for long-term development projects, infrastructure improvements, or other welfare-enhancing activities.[10] Additionally, the drain of repatriating profits may in fact harm a capital-importing country's balance of payments, if FDI flows are not consistently renewed and outward transfer of profits continues.

These concerns were part of the impetus that drove the "new international economic order" movement among developing countries. In 1974, as part of a movement that became known as the "New International Economic Order" (NIEO), a large number of States initiated a campaign against the prevailing norms of equal treatment for foreign investors, culminating in a U.N. resolution known as the Charter of Economic Rights and Duties of States.[11] These States advocated preferential treatment for local capital. The Charter set forth a new standard for the treatment of investments, although the standard was vehemently opposed by developed countries in the General Assembly: "Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities."[12] While the general exhortatory provisions of the Charter were approved by a wide margin, the most controversial provision—article 2, which purported to remove the act of nationalization from the protections of international law—was passed over the objections of all the major industrialized nations, as well as several developing countries.[13]

Economies of Central and Eastern Europe?, Columbia FDI Perspectives on Topical Foreign Direct Investment Issues, No. 236 (Oct. 8, 2018), available at http://ccsi.columbia.edu/files/2016/10/No-236-Kekic-FINAL.pdf

[8] As a result, a number of recent investment agreements have attempted to refine the definition of "investments" in a way that reflects the economic priorities and social expectations of the host State, by requiring specific characteristics or linking the concept of "investment" to contributions to sustainable development; *see e.g.* Hamed El-Kady, *Towards a New Conceptualization of International Investment Agreements*, BCDR 3(2) Int'l Arb. Rev. 331 (2016).

[9] World Bank, 1 World Debt Tables 1992–93, at 20–21 (1992).

[10] Ibrahim Shihata, Legal Treatment of Foreign Investment: The World Bank Guidelines 9 (1993).

[11] G.A. Res. 3281, 29 U.N. GAOR Supp. (No. 31), at 50, 51–55, U.N. Doc. A/9631 (1974), *reprinted in* 14 I.L.M. 251, 252–60 (1975), available at www.un.org/documents/resga.htm. *See* Patricia Robin, *The BIT Won't Bite: The American Bilateral Investment Treaty Program*, 33 Am. UL Rev. 931 n.93 (1984).

[12] 29 U.N. GAOR Supp. (No. 31) at 52, 14 I.L.M. at 254–55, *supra* note 11.

[13] Robert von Mehren & P. Nicholas Kourides, *International Arbitration between States and Foreign Private Parties: The Libyan Nationalization Cases*, 75 AJIL 476, 523 (1981).

In this atmosphere of conflicting interests, some governments in the Middle East and Africa turned to nationalization of foreign investment as an economic and political tool, in part as an assertion of "permanent sovereignty" over natural resources following de-colonialization.[14] Many of these expropriations took place despite elaborate, long-term concessions that the host States had granted to foreign investors.[15] Expropriations of foreign investment continued into the 1970s in States such as Uganda, Ethiopia, Pakistan, and Iran. By 1980, the only OPEC (Organization of Petroleum Exporting Countries) States where oil concessions benefitting multinational corporations remained in effect were the United Arab Emirates and Libya. This represented a substantial deterioration in stability from the middle part of the twentieth century.[16] (These historical developments are elaborated on in Chapter 5.)

However, the NIEO ultimately had little impact on targeted institutions such as the Bretton Woods system, the GATT, and the WTO. Subsequent attempts to include NIEO principles in documents elaborating development strategy also failed to obtain any consensus.[17] By the beginning of the 1990s, with the fall of Communist regimes in Europe and the onset of debt crises throughout the developing world, the NIEO appeared to have fallen into wide disfavor. In its place, a more balanced, pragmatic approach to foreign economic participation gained currency, one that recognized both the so-called humanitarian risks of unregulated capitalism and the simple fact that "less-developed countries compete on a worldwide scale for scarce private investment capital, and that capital will not come unless there is security and a good chance of profit making."[18]

States formerly hostile to foreign investment have enacted investment codes favorable to investors,[19] and have adopted legal and business methodologies familiar

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[14] On the concept of permanent sovereignty and rights to oil deposits in international law, *see* David M. Ong, *Joint Development of Common Offshore Oil and Gas Deposits: "Mere" State Practice or Customary International Law?* 93 AJIL 771 (1999).

[15] *See* Vratislav Pechota, *The 1981 U.S.–Czechoslovak Claims Settlement Agreement: An Epilogue to Postwar Nationalization and Expropriation Disputes*, 76 AJIL 639. *See also* Rode, *The American–Polish Claims Settlement Agreement of March 30, 1960*, 55 AJIL 452 (1961); Gordon Christenson, *U.S.–Rumanian Agreement of March 30, 1960*, 55 AJIL 452 (1961); Richard B. Lillich, *The United States–Bulgarian Claims Agreement of 1963*, 58 AJIL 187 (1964); Branko Pesel.j., *The New Yugoslav–American Claims Agreement*, 59 AJIL 362 (1965); Expropriation in the Americas (Andreas Lowenfeld ed. 1971); Eric N. Baklanoff, Expropriation of U.S. Investment in Cuba, Mexico, and Chile (1975).

[16] Edith Penrose et al., *Nationalization of Foreign-Owned Property for a Public Purpose: An Economic Perspective on Appropriate Compensation*, 55 Modern L. Rev. 351, 353 (1992).

[17] Russel Lawrence Barsh, *A Special Session of the U.N. General Assembly Rethinks the Economic Rights and Duties of States*, 85 AJIL 192, 192–93 (1991).

[18] Frank Ruddy, *Book Review: Foreign Investment in the Present and a New International Economic Order*, 84 AJIL 961, 962 (1990).

[19] Ibrahim F.I. Shihata, *Recent Trends Relating to Entry of Foreign Direct Investment*, 9 ICSID Rev.—For. Inv. L.J. 47 (1994). For a discussion of the national foreign direct investment codes of several nations, *see* Michael A. Geist, *Toward a General Agreement on the Regulation of Foreign Direct Investment*, 26 L. & Pol'y. Int'l Bus. 673, 686–706 (1995); Antonio Parra, *Principles Governing*

to foreign enterprises, such as Anglo-American methods of contract interpretation.[20] Many developing States have also passed legislation guaranteeing compensation in the event of expropriation,[21] and have entered into bilateral investment treaties with capital-exporting countries, which normally establish a range of baseline guarantees to qualifying investors.

Also, in a reversal of the previously dominant doctrine that investment disputes should be resolved under the laws and within the judicial system of the host state,[22] many developing States have enacted investment laws allowing for settlement of disputes in a neutral forum, using the facilities and procedural rules of arbitral institutions such as the International Chamber of Commerce and International Centre for the Settlement of Investment Disputes.[23] Likewise, regional and bilateral investment treaties have multiplied around the globe, often providing foreign investors both substantive protections and mandatory arbitration of disputes.[24] Finally, there have been a number of incentives offered by developing States to attract foreign direct investment, including tax breaks, inexpensive financing, and land at reduced prices.[25]

Foreign Investment as Reflected in National Investment Codes, 7 ICSID Rev.—For. Inv. L.J. 428 (1992). International organizations have also shifted their emphasis from the regulation of foreign direct investment to the liberalization of government policies toward such investment. *See* Brewer, *supra* note 2, at 639; *see also* OECD, *Checklist for Foreign Direct Investment Incentives* (2003), available at www.oecd.org/dataoecd/45/21/2506900.pdf (providing a guide for policy makers on the liberalization of their home economy in order to attract further investment). However, several countries have recently started introducing various investment restrictions and controls. *See e.g.*: Karl P. Sauvant, *The Regulatory Framework for Investment: Where Are We Headed?*, 15 Research in Global Strategic Management 407–33 (2011).

20 For a discussion of such practices in Central and Eastern Europe, *see* Gray & Jarosz, *supra* note 2, at 32.

21 For examples of such legislation in Central and Eastern Europe, *see id.* at 29; Geist, *supra* note 19.

22 On this so-called "Calvo Doctrine," *see* Donald Shea, The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy (1955).

23 Adeoye Akinsanya, *International Protection of Direct Foreign Investments in the Third World*, 36 Int'l & Comp. LQ 58, 70–75 (1987). Despite the benefits of introducing investor–State dispute resolution mechanisms, it is still unclear whether such a regime has helped host States attract foreign investments. *See e.g.* Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 Va. J. Int'l L. 397 (2010); U.N. Conference on Trade and Development, The Impact of International Investment Agreements on Foreign Direct Investment: An Overview of Empirical Studies 1998–2004, Working Draft (2014).

24 On the wider implication of such investment treaties, *see* Marian Nash (Leich), *U.S. Practice: Bilateral Investment Treaties*, 87 AJIL 433 (1993). *See also* Tillman Rudolf Braun, *Globalization: The Driving Force in International Investment Law*, in The Backlash Against Investment Arbitration (Michael Waibel et al. eds. 2010); Stephen M. Schwebel, *The Overwhelming Merits of Bilateral Investment Treaties*, 32 Suffolk Transnat'l L. Rev. 263 (2009); J.X. Zhan, *The Spread of BITs and Their Changing Face*, 24 ICSID Rev.—For. Inv. L.J. 339 (2009); However, according to UNCTAD, the number of effective treaty terminations outpaced the number of new IIAs signed in 2017.

25 Geist, *supra* note 19, at 679.

To some degree, these changes were probably brought about as a result of competition among developing states for FDI. As developing States' demand for foreign direct investment increased in the late 1970s and early 1980s, the supply of available capital was decreasing significantly.[26] While FDI to developing countries reached a peak of US$17.24 billion in 1981, it fell to US$11.86 billion in 1982 and US$7.8 billion in 1983.[27] This was due in part to rising interest rates and falling commodity prices, causing many developing States to default on their debts to Western banks in the 1980s.[28] This series of defaults caused some international banks and investors to tighten the supply of capital flowing to these States. Many multinationals took to borrowing funds from their foreign subsidiaries, rather than injecting capital into them.[29] One way States found to attract an ever-smaller pool of foreign funds was to liberalize the local regulatory regime, and to provide other guarantees that reduce the political risk that would otherwise make investing expensive.[30]

As a consequence of the market liberalization and developing States' apparent embrace of FDI, one could assume that foreign investors would look forward to ever-decreasing political risk in the twenty-first century.[31] But despite new laws and treaties, as well as a new culture of mutual benefit between capital exporters and capital importers, the potential for a trend reversal remains real, and political risk concerns persist.[32] Such a trend is more likely to occur during financial crises, such as the 2001–02 Argentinian crisis or the global financial disruption

[26] In 1993 and 1994, it is estimated that half of all foreign direct investment flowing to developing countries went to East Asia and to the Pacific, while lower income countries, excluding China and India, received only about US$3 billion. MIGA, Annual Report 1995, available at http://www.miga.org.

[27] Organisation for Economic Cooperation and Development (OECD), Development Cooperation—1984 Review 64, Table IV-1 (1984).

[28] The total debt of developing countries exceeded $950 billion in 1985, causing the international capital flow to developing countries to slow and interest rates to rise. Shihata, *supra* note 10, at 672.

[29] *Id.* at 674.

[30] "Political risk" can be broadly defined as the risk that the laws of a country will change to the investor's detriment after it has invested capital in the country, reducing the value of its investment. Put simply, it is the risk of adverse government intervention. *See* Philipp Harms, International Investment, Political Risk, and Growth (2000); David A. Jodice, Political Risk Assessment: An Annotated Bibliography (1985); *see also* Thomas Nektarios Papanastasiou, The Legal Protection of Foreign Investments against Political Risk: Japanese Business in the Asian Energy Sector (2015).

[31] Expropriations appear to have peaked in 1975, with eighty-three expropriations in twenty-eight different countries, but declined by 50 percent the following year. Between 1980 and 1985, the rate of expropriation averaged three per year. U.N. Centre on Transnational Corporations, *The New Environment,* UNTC Current Studies, Series A, No. 16 (New York: United Nations, 1990), at 18.

[32] *See generally* Peter B. Kenen, The International Financial Architecture (2001); Andreas Lowenfeld, International Economic Law 565–616 (2002); Grant Nulle, *IMF Ignores Causes of Crisis*, Financial Times, Aug. 18, 2003, at 10; Adam Thomson, *Argentina Defiant towards Private Creditors*, Financial Times, Mar. 11, 2004, at 11.

that resulted from the 2008 sub-prime loan debacle. The current global instability has affected developed and developing countries alike, and resulted in a decrease in global cross-border capital flows (exacerbated by difficulties in the Eurozone)[33] and an increase in the regulation of foreign investments and limits on the entry of foreign investments (a trend described as "investment protectionism").[34] Moreover, UNCTAD highlights that in 2017 the number of treaty terminations for the first time outpaced the number of new IIAs signed, and that many countries have agreed to replace their existing investment treaties with those exhibiting a "sustainable development orientation, preservation of regulatory space and improvements to or omissions of ISDS."[35]

Today, host States can interfere with private property and foreign investment more subtly than through direct confiscation and transfer of title. Over the last few decades, the risk of indirect, *de facto* or regulatory expropriation, or of other, less extreme interference, has come to the forefront of business consciousness in the developing world.[36] Moreover, there is an ongoing discussion about how non-investment concerns such as human rights affect a host State's liability to compensate investors for expropriation. This discussion follows a general debate regarding the integration of human rights law into international investment law.[37] Thus,

[33] Susan Lund et al., *The New Dynamics of Financial Globalization*, McKinsey Global Institute Report (2017), available at https://www.mckinsey.com/industries/financial-services/our-insights/the-new-dynamics-of-financial-globalization

[34] Since the global financial crisis that began in 2008, several States have banned inward FDI for national security reasons; *see* M. Sornarajah, The International Law on Foreign Investment 168–69 (3d ed. 2010); *see also* Alvaro Cuervo-Cazurra, *Host Country Concerns and Policies toward State-Owned MNEs*, Columbia FDI Perspectives on Topical Foreign Direct Investment Issues, No. 237 (Oct. 22, 2018), available at http://ccsi.columbia.edu/files/2016/10/No-237-Cuervo-Cazurra-FINAL.pdf. The Committee on Foreign Investment in the United States (CFIUS) increasingly undertakes national security reviews of cross-border transactions involving Chinese State-owned enterprises, based on the concern that Chinese enterprises or sovereign wealth funds could gain access to natural resources, technology, or other vital sectors of the American economy through mergers with U.S. companies, compromising U.S. national security. *See e.g.* Zhang Monan, *Investment Protectionism in the Name of National Security*, China–US Focus (Sept. 6. 2017), available at https://www.chinausfocus.com/finance-economy/investment-protectionism-in-the-name-of-national-security

[35] UNCTAD—Issues Note 2018, *Recent Developments in the International Investment Regime* (2018).

[36] It is not straightforward to distinguish host-State measures that constitute indirect expropriation (which requires adequate compensation) from regulatory measures that do not constitute expropriation and therefore do not require compensation. *See* Vera Korzun, *The Right to Regulate in Investor–State Arbitration: Slicing and Dicing Regulatory Carve-Outs*, 50(2) Vand. J. Transnat'l L. 375 (2017); *see also* Katia Yannaca-Small, *Indirect Expropriation and the Right to Regulate: How to Draw the Line?*, in Arbitration under International Investment Agreements: A Guide to the Key Issues 445–77 (Katia Yannaca-Small ed. 2010).

[37] *See* the analysis in Chapter 11.

even when an investor remains in full control of his assets, he may find their value evaporated no less effectively than in an outright taking.[38]

Nevertheless, the political risks described in this book are not restricted only to developing and transition economies. Indeed, recent cases before several arbitration tribunals and the European Court of Human Rights demonstrate that overzealous regulators and the demands of local interest groups at times can make even the most "advanced" country a risky place for the foreign investor.[39]

Whether an investor brings capital to a developed or developing country, how can he assess and manage the incumbent political risk before deciding whether to invest? What can an investor do to deter manifestations of political risk once the investment has been made? How can international law be brought to bear as protection against political risk? Finally, what remedies are available if political risk materializes to the investor's detriment? This book is an attempt to suggest some answers to these questions.

In the first part of the text, we offer guidance on the assessment and pre-investment management of political risk. In Chapter 1, we discuss the types of political risk that foreign investors are likely to encounter, and suggest some practical steps that might be taken to measure such risk in a particular State before investing capital. We then turn to the actions that the investor can take to reduce exposure to political risk prior to investing. Chapter 2 analyzes the types of investment projects most often undertaken in developing States, and provides an analysis of the structures that can be implemented to reduce exposure to political risk. Chapter 3 deals with the modalities of political risk insurance, which typically provides coverage against non-commercial risks such as currency inconvertibility, expropriation, and war, and is available from nationally sponsored insurance agencies, private insurance companies, and the World Bank's Multilateral Investment Guarantee Agency.

In the second part of the book, we turn to the international law framework of investment protection and political risk. Chapter 4 covers the general background international law pertaining to State responsibility, in particular State responsibility incurred in relation to foreign investment, as well as the general nature and types of remedies available to investors when a State expropriates an investor's property or interferes with its investment. In Chapter 5, we discuss the principles of customary international law related to expropriation. This chapter includes an

[38] *See Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award of Mar. 9, 1998, 40 I.L.M. 36 (2001), at para. 103 (the host State's regulatory action can have the effect of an outright taking).

[39] *See e.g. Loewen Group Int'l v. U.S.A.*, ICSID Case No. ARB(AF)/98/3, 42 I.L.M. 811 (2003), Award of June 26, 2003 (a U.S. trial court's conduct toward a Canadian investor was "a disgrace by any standard" and violated international standards of fair and equitable treatment).

overview of the historical development of the international law of expropriation, as developed in international arbitration decisions, commentators, treaties, and State practice. The current state of the customary international law of expropriation is also discussed, including the various substantive protections established in customary and conventional international law, such as the "full compensation" standard for expropriation, the public purpose requirement, and the prohibition against discrimination.

Investors look not only to customary international law principles, however: they increasingly rely on the substantive protections provided in a growing number of investment treaties. The modern international law of investment protection as embodied in multilateral and bilateral investment treaties, including principles such as fair and equitable treatment, and full protection and security, is covered in Chapter 6. Also included is a detailed discussion of methods of valuation of damaged or expropriated property.

Finally, in a third section, we provide practical guidance on the procedural recourse available to investors who face political risks that have materialized. Chapter 7 concerns the jurisdictional requirements for invoking investment treaty protections—who has standing to maintain a claim, what assets qualify as protected "investments," and the effect of related contractual forum selection clauses. In Chapter 8, we provide an overview of international arbitration procedure—both under arbitration treaties and contractual arrangements—particularly under the auspices of the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) and arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL). Next, Chapter 9 addresses the possibility of mediation, conciliation, and other non-litigious forms of alternative dispute resolution, methods which have drawn significant attention in recent years. In Chapter 10, we discuss the actions that an investor's home government may take to protect the investor in response to unreasonable host-State interference with investment. Finally, Chapter 11 explores the procedural and substantive interaction between international investment law and international human rights, analyzing the most recent investment arbitration decisions. It considers whether foreign investors can raise human rights arguments, and whether host States can introduce human rights defenses into investment arbitration adjudication, examining the interactions between international investment provisions and human rights.

Every author must ultimately end his research and choose his field of battle, even so broad a field as the one we attempt to cover here. This book is limited in scope to the topics just described, and does not address the related and vitally important topics of commercial risk involved in direct foreign investment;[40] business,

[40] Commercial risks are the types of risks inherent in any business venture, such as the risk of

financial, or tax strategies for FDI;[41] or political risks connected with import/export transactions and portfolio investment.[42] Nor do we discuss the political risks of any particular country in detail. Because such risks necessarily evolve over time, such a discussion would be of limited value. There are, however, several services that provide up-to-date political risk assessment on a country-by-country basis.[43]

Cross-border investment has become a central driving force in local economies around the world. Indeed, more than ever private investment and trade, as much as national politics, shape the development of global commerce.[44] In part through the management of political risk, private parties—and their counsel—are today called upon to help draw the contours of international law alongside national legislatures and executives.[45]

This unconscious collaboration may at first seem an odd result of the historical clash between capital importers and capital exporters. But on further reflection, it is only natural that private investors and the States where they seek their fortune should find common ground, even if by way of occasional collisions. The increased flow of investment means new opportunities for those businesses willing and able to assess and address political risk, and at the same time offers the surest path to sustainable growth for countries too small or impecunious to rely on domestic capital. Furthermore, the tables began to turn on the traditional capital exporting States: formerly less-developed countries now invest heavily abroad, including projects in Western Europe and North America. Some of the world's most developed countries are therefore softening their previously uncompromising

low consumer demand, higher than expected manufacturing costs, insolvency of purchasers, and cost overruns in production. Commercial risk is thus the business risk that remains even in the most stable political climate. While commercial risks affect any business, whether operating in its home country or abroad, these risks are often greater in a developing country due to lack of a developed infrastructure, primitive telecommunications systems, and an unskilled, uneducated, and relatively impoverished consumer base. As a practical matter, however, it may sometimes be difficult to distinguish between political and commercial risks. For example, the failure of a government-operated utility to deliver services to an investor's facility may be either commercial or political in nature. On commercial risk and commercial risk management, *see* Tim Boyce, Commercial Risk Management (2003).

41 Raymond Rody, International Business Negotiations: Strategies, Tactics and Practices (2002); Peter Buckley, The Strategy and Organization of International Business (1993).

42 Yen Yee Chong, Investment Risk Management (2004).

43 *See* The Economist Intelligence Unit, *Country Reports*, available at http://www.eiu.com; *see also* The Economist Intelligence Unit, *Country Risk Service*, available at http://www.eiu.com.

44 *See* Susan Strange, The Retreat of the State: The Diffusion of Power in the World Economy (1996); Susan Strange, Mad Money: When Markets Outgrow Governments (1998).

45 *See e.g.* Tamara Lothien & Katharina Pistor, *Local Institutions, Foreign Investment and Alternative Strategies of Development: Some Views from Practice*, 42 Colum. J. Transnat'l L. 101, 106.

pro-investor approach in anticipation of conflicts where roles are reversed and they are compelled to defend their own regulatory actions.[46]

Therefore, most foreign investment participants understand the delicate balance between international law constraints and the legitimate interests of development and sovereignty.[47] The increased control over political risk that private investors now enjoy, in part as a result of the investment treaties that States themselves conclude, is mutually beneficial. States have insulated themselves from external political pressure and lowered the cost of foreign investment by demonstrating their resolve to provide a predictable investment climate. At the same time, private investors must properly appreciate the extent of their new rights if they are to lower political risk and the accompanying financial burden.

[46] *See* Noah Rubins, *Loewen v. United States: The Burial of an Investor–State Claim*, 21 Arb. Int'l 1, 32–36 (2005); Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, Mealey's Int'l Arb. Rep. (January 2004), at 39, 41. There is a growing trend of foreign investments flowing from emerging markets' firms to developed States. Investments by developing country firms in other developing counties (known as "South-South" investment) are also at a higher level; *see* Rudolf Dolzer & Christoph Schreuer, Principles of International Investment Law 7–8 (2d ed. 2012); *see also* Anabel Gonzalez et al., *South-South Investment: Development Opportunities and Policy Agenda*, The World Bank (Mar. 28, 2015), available at http://blogs.worldbank.org/trade/south-south-investment-development-opportunities-and-policy-agenda

[47] The maze of bilateral and multilateral investment treaties bears witness to this development. *See e.g.* K.V.S.K. Nathan, The ICSID Convention: The Law of the International Centre for Settlement of Investment Disputes (2000).