PART 1 – FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW

Chapter 1.1
The Setting and Classic Problem in International Investment Situations

By Frank Emmert

An international investment situation arises when an investor from one country – the home country – invests money and other resources in another country – the host country – to create a for-profit investment.[1] An "investor" can generally be a natural or a legal person. An "investment" can take many different forms. However, only two basic types of investment need to be distinguished at the present time: Foreign Direct Investment (FDI), and Foreign Portfolio Investment (FPI).

1) Foreign direct investment either creates in the host country a new company (co-)owned and (co-)controlled by the foreign investor, or it creates in the host country a new branch or subsidiary of the foreign investor. In some cases, a foreign direct investor merges with or acquires an existing business in the host country, with the intention of using a controlling interest for the development and expansion of this business. In other cases, the foreign direct investor may enter into a joint-venture with an existing business in the host country. Even if the foreign investor does not acquire a controlling interest, s/he needs to take or at least intend to take an active role in the management of the host country entity.[2]

Foreign direct investment is not only the initial investment or transaction but also every subsequent transfer of capital or other assets from the investor to the investment in the host country.

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[1] Sornarajah defines foreign investment as "the transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets" (M. Sornarajah, *The International Law on Foreign Investment*, Cambridge Univ. Press, 3rd ed. 2010, p. 8). Since different Bilateral Investment Treaties (BITs) and Multinational Investment Agreements (MIAs) contain different definitions of protected types of investment, the rights of investors have to be determined on a case-by-case basis. Many modern BITs and MIAs no longer require a profit-seeking motive and even apply to investment into not-for-profit entities. For example, the 2008 German Model BIT defines "investor" as "any natural person... [and] any juridical person... which in the context of entrepreneurial activity is the owner, possessor or shareholder of an investment in the territory of the other Contracting State, *irrespective of whether or not the activity is directed at profit*" (Art. 1(3)(a), emphasis added). For discussion see Luke Eric Peterson & Nick Gallus, *International Investment Treaty Protection of Not-for-Profit Organizations*, Int'l J. Not-for-Profit Law 2007, Vol. 10, No. 1, pp. 47-76.

[2] OECD guidelines indicate that ownership of 10% or more of the voting power by a single investor is evidence for a sufficient degree of involvement. See OECD Benchmark Definition of Foreign Direct Investment, 4th ed. 2008, Chapter 3: Main Concepts and Definitions of Foreign Direct Investment, at pp. 48-49.

Foreign investment may also involve the acquisition of assets or rights without the creation or involvement of a company. Examples would be the acquisition of real estate or mining- or intellectual property rights. If assets are acquired for business development purposes, they usually qualify as foreign direct investment. If assets are primarily acquired for storage or accumulation of wealth, they do not indicate foreign direct investment but they may still be protected forms of investment.

2) In case of foreign portfolio investment, the foreign investor acquires a relatively smaller amount of shares or other forms of equity or debt securities in a company that already exists in the host country. In this case, the foreign investor becomes an indirect (co-)owner, typically does not seek majority ownership or control, does not actively participate in the management of the host country entity, and does not acquire physical assets.

The main difference between the two forms of investment is the fact that direct investments usually take considerable time and effort to bear fruit, and the direct investor cannot easily get out of her commitments without losing much or all of the investment already made. By contrast, securities acquired in a portfolio or indirect investment are usually tradeable on organized markets, like stock exchanges, and allow investors to get in and out at any time. While the portfolio or indirect investor brings and takes only money, the direct investor creates and/or develops a business before she can hope to take any money (profits).

Since portfolio investors usually remain passive minority shareholders and make no long-term commitment, their investment into host country securities has only limited exposure to the legal and regulatory environment of the host country. As a consequence, portfolio investments were traditionally not protected under customary international law. By contrast, direct investors and the business they are trying to create or expand, are fully immersed in the legal and regulatory environment of the host country. Moreover, direct investors are not only bringing capital but also a range of other resources from the home country to the host country, including intellectual property, know-how, management and other professional services, etc. In many cases, direct investors will be personally involved and spend considerable time in the host country and they may bring large teams with managerial, engineering, marketing, and other skills that are needed for the business, at least until a similarly qualified workforce is developed in the host country.

The difference between the acquisition of negotiable/tradeable securities on the one side and the acquisition and strategic development of a business on the other side typically requires a significantly longer commitment by the direct investor. This translates into a significantly greater exposure to a variety of risks, in particular so-called political risks. Examples of political risks associated with direct investments in foreign countries are fundamental changes in government, sometimes in the form of a military coup or revolution, fundamental changes in the constitutional and legal system, as well as fundamental changes to the economic system, e.g. a shift from a market economy to a socialist planned economy without private ownership of production factors. Such fundamental changes are hard to predict and may well affect the core assumptions the foreign direct investment was based on. In other words, such fundamental changes may make it impossible for the foreign investor to continue the business, or to do so in a

profitable way, and may do so before the investment has yielded any profits. As a consequence, direct investors and investments have traditionally been deemed worthy of and in need of some level of protection.

The primary protections traditionally provided to foreign investors are the legal system and the courts in the host country. Governments are usually open to the idea of being sued in their own courts because they have some level of control over those courts. First, the legislature determines the procedural rules, including topics such as conditions of standing, statutes of limitations, permissible evidence, and available remedies. Second, even democratic governments have some level of control over the appointment of their judges and, as a general trend, only proven, predictable and conservative judges will be appointed to the highest courts in a country. Third, the domestic courts have to apply the domestic substantive law, and that is again controlled by the legislature. Thus, if a new law is adopted that increases the taxes or the minimum wage, or introduces stricter labor or environmental protections, it is highly unlikely that a domestic court would consider this worthy of compensation for foreign investors, even if it means that their original business plans are no longer viable. And in undemocratic countries, if an investment is taken away and transferred to friends or family of the local dictator, it is highly unlikely that a court or judge would stand up against the decision and try to provide compensation to the investor. This means, of course, that foreign investors by and large do not have a lot of faith in remedies provided by the domestic courts of the host country.[3]

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[3] The problem is rather more widespread and dramatic that it may seem at first glance. I have been teaching an annual workshop at Tulane University, in the framework of the Legislative Drafting Institute, entitled “The Global Failure of Justice Systems”. In this workshop – and in several publications related to it – I have been arguing that I would not want to entrust the fate of my client to the domestic courts of a foreign country in 9 out of 10 cases. In particular, if large amounts of money are at stake, if my client is a foreigner or belongs to a minority, if the respondent is politically connected or an important employer or tax payer, or if time is of significance, I do not trust the courts in about 180 out of 200 countries to deliver a fair and enforceable decision within a reasonable time. In some countries, judges are just poorly trained and have insufficient resources to handle their case-load, which is exacerbated in complex international cases, and makes for unpredictable outcomes. In other countries, political pressure and/or corruption frequently pollutes the judicial process. In yet other countries, the courts and judges do a reasonably good job but it just takes too long to get a final and enforceable decision because of almost infinite options for local lawyers to delay the process with procedural motions, appeals, and other tricks. *Nota bene* that I am not saying *that it is not possible* to get a fair and enforceable decision in a reasonable time in countries like Egypt, India, Italy, or Turkey. However, there are just too many cases that have been kicked around the courts in these countries (and many others like them) for a decade and more. Similarly, I am not saying that it is not possible to get a fair and enforceable decision in countries like China or Russia. However, the military in China, and politically connected parties in Russia (and many other countries like them) have all too often been able to bend the arc of justice in their favor. The bottom line is simple: If I don’t feel confident that my client’s chances of getting a fair trial and an enforceable decision based on the rule of law within a reasonable time are at least 95%, I cannot in good faith recommend or plan for litigation in such a country, in particular if I have choices because I am still in the phase of planning an investment and drafting the relevant contracts. 2 out of 3 trials going well is just not good enough! For further analysis see Frank Emmert, *Global Failure of Justice Systems – Causes and Consequences*, 2019, https://www.researchgate.net/publication/336083737_Global_Failure_of_Justice_Systems_-_Causes_and_Consequences.

In addition, foreign investors, as nationals of their home countries, enjoy a basic level of protection under public international law. On the one hand, as citizens of their home countries, individuals and their assets enjoy a level of diplomatic protection. On the other hand, customary international law and its regime for state responsibility[4] provides a minimum standard below which a host state cannot go without triggering liability. In practice, this means that "aliens" may have to be treated better than the host country's own nationals. While a country is generally not prevented from expropriating its own nationals, it cannot expropriate foreigners without incurring, at least potentially, some responsibility. However, as we will see in Chapter 1.7, these protections can only be claimed by the home country, not by the investors themselves. This can be frustrating for the investors because they will be subject to political decisions made by their home country, along the lines of "is this a sufficiently important matter and a good time to start a dispute with the host country?". Furthermore, even if any compensation for expropriation or other mistreatment should be made, the host country makes the compensation to the home country and the latter may or may not agree to pass some or all of it on to the investor.

Outside of the domestic courts of the host country, and any diplomatic and legal protection potentially provided by the home country, investors traditionally did not have many good options. In particular, sovereign states around the world have always been extremely reluctant to grant opportunities to individuals – whether their own or foreign nationals – to directly call upon any international courts to hold a sovereign state accountable for any violations of international customary- or treaty law. On the one hand, the traditional definition of "sovereignty" used by monarchs and other absolute rulers can be summarized as "nobody tells me nothing what to do". On the other hand, states have always worried about private litigants who are indifferent to political considerations and potentially very numerous. Although modern states with democratically elected governments are hardly comparable to those absolute rulers, the attitude toward international law and international relations has not changed all that much. Indeed, the European Court of Human Rights, the Inter-American Court of Human Rights, and most recently also the African Court of Human and Peoples' Rights, are pretty much the only international courts that can accept direct claims from private individuals against a state that signed on to the respective convention and, therefore, voluntarily submitted itself to the jurisdiction of these courts. Unsurprisingly, even under these human rights conventions, there are many hurdles to be taken by the plaintiffs before they can reach the international court level,[5] and the available remedies for successful plaintiffs are underwhelming.[6]

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4 In this regard it is widely – but by no means universally – accepted that the International Law Commission's *Draft Articles on Responsibility of States for Internationally Wrongful Acts* (submitted to the UN General Assembly in 2001, https://legal.un.org/avl/ha/rsiwa/rsiwa.html) represent a codification of customary international law on the matter. See the discussion in the UN Legal Committee of 19 October 2010, GA/L/3395. For further analysis, see Chapter 1.3.

5 Both the 1950 European Convention for Protection of Human Rights and Fundamental Freedoms (in Art. 35) and the 1969 Inter-American Convention on Human Rights (in Art. 46) require the exhaustion of domestic remedies, i.e. trial courts and any available appeals, before a case can be brought to the international level. Both have cumbersome additional procedural requirements and short time-lines. For details see, Council of

The creation of additional and better protections and remedies directly for foreign investors is the very essence of international investment law.

In addition to the fairly rudimentary instruments of customary international law, relevant investment protection rules can be found in

- bilateral investment treaties (BITs) between home states and host states,
- multilateral investment agreements (MIAs) between groups of states,
- treaties with investment provisions (TIPs) that otherwise have different or broader foci, and

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Europe (ed.), *Bringing a Case to the European Court of Human Rights – a Practical Guide on Admissibility Criteria*, Strasbourg 2012; Philip Leach, Taking a Case to the European Court of Human Rights, Oxford Univ. Press, 4th ed. 2017; as well as Inter-American Court of Human Rights, How to Present a Petition to the Inter-American Human Rights System?, https://corteidh.or.cr/como_acceder_al_sistema.cfm?lang=en.

The 1981 African Charter on Human and Peoples' Rights (Banjul Charter) initially only provided for an informal procedure for individuals to bring human rights violations to the attention of the African Commission on Human and Peoples' Rights (Art. 56). By way of the 1998 Protocol to the African Charter on Human and Peoples' Rights on the Establishment of an African Court on Human and Peoples' Rights (Ouagadougou Protocol), a mechanism for cases to be brought before the newly created African Court was also provided (Art. 5). The Protocol was signed by 52 African States and – so far – ratified by 30 of them. However, Article 5(1) only gives the right to submit cases to the African Court to the African Commission, State Parties, as well as African Intergovernmental Organizations. The additional option for individuals and certain non-governmental organizations (NGOs) to bring such cases is foreseen in Article 5(3). The necessary declaration pursuant to Art. 34(6) of the Protocol has been submitted by Benin (2016), Burkina Faso (1998), Cote d'Ivoire (2013), Ghana (2011), Malawi (2008), Mali (2010), Tanzania (2010), The Gambia (2020), and Tunisia (2017). Exhaustion of local remedies is required (Art. 50 of the African Charter). As of November 2022, the African Court has received 330 cases, closed 164, and rendered 10 judgments on the merits. For details see https://www.african-court.org/cpmt/decisions.

[6] Indeed, at least the European Court of Human Rights has pursued for many years a policy of granting very modest financial compensation in most cases, to the extent that compensation of a few thousand Euros for violations such as unduly lengthy judicial proceedings in criminal cases, frequently does not even cover the travel expenses of the lawyers to Strasbourg, let alone the full cost of the legal representation through all levels of national and international remedies, let alone any actual compensation for the human rights violation. The Court openly does so because it does not want to encourage more cases to be brought beyond the flood it already receives, and it does not want to push countries like Russia, Ukraine, Turkey, or Italy, which have many such complaints, to renounce the Convention because the financial burden becomes insupportable. Source ??? See also Elisabeth Lambert Abdelgawad, *Is There a Need to Advance the Jurisprudence of the European Court of Human Rights with Regard to the Award of Damages?*, in Anja Seibert-Fohr & Mark Villiger (eds.), *Judgments of the European Court of Human Rights - Effects and Implementation*, Routledge 2014, pp. 115-136. Yet, even after the Court exercises significant self-restraint, non-compliance with compensation awards is a real problem. See, for example, Veronika Fikfak, *Changing State Behaviour: Damages Before the European Court of Human Rights*, European Journal of Int'l Law 2018, Vol. 29, No. 4, pp. 1091-1125; as well as Veronika Fikfak, *Compliance and Compensation: Money as a Currency of Human Rights*, in Rachel Murray & Debra Long (eds.), *Research Handbook on Implementation of Human Rights in Practice*, Edward Elgar 2022, pp. 98-118. Needless to say, if individuals have to overcome many hurdles to get to an international forum, and even if successful there receive little in compensation, and even that can be simply ignored by the respondent state, the states are not exactly going to feel much pressure to improve their human rights record...

- contracts directly between investors and host state governments.

All of these instruments may provide substantive standards for the treatment of investors and/or procedures and remedies for investors state dispute settlement (ISDS). To the extent that protection is provided via treaties, these are usually public and available for current and future investors and researchers. By contrast, investor-state contracts are often confidential and it may take an international dispute to reveal at least some of their provisions.

The earliest international investment protection instruments go back to the 17th century but the system really became widely used and dynamic only in the 1960s and 70s. Since then, however, international investment law and ISDS have become mainstream subjects for legal study and practice and should be part of any commercial internationalization strategy and supply-chain development decision!

As of November 2022, the United Nations Conference on Trade and Development (UNCTAD) *International Investment Agreements Navigator*[7] lists 2,850 BITs, of which no fewer than 2,221 are currently in force. In addition, the website provides information on 432 MIAs and TIPs, of which 354 are currently in force. For almost all agreements that are in force, UNCTAD provides free access to the full text, often in multiple languages. Another excellent source of treaty law is provided by the International Centre for Settlement of Investment Disputes (ICSID), part of the World Bank Group. ICSID has a searchable *Database of Bilateral Investment Treaties* on its website,[8] as well as a database of *Other Investment Treaties*.[9] Analysis of different generations of BITs and MIAs shows notable evolutionary developments, both with regard to procedure and substance of the treaties.

Beyond the statutory provisions of the investment-related treaties, the interpretation and application of these treaties, in particular in ISDS cases, has to be taken into account. Although there is no rule of *stare decisis* in ISDS, and each case has to be decided on its own merits, the finest arbitrators will always explain why they are following a particular precedent, and not another, in order to strengthen the persuasiveness of their arguments and the legitimacy of the system overall.[10] While commercial arbitration awards are frequently confidential, the awards

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[7] https://investmentpolicy.unctad.org/international-investment-agreements.

[8] https://icsid.worldbank.org/resources/databases/bilateral-investment-treaties.

[9] https://icsid.worldbank.org/resources/databases/other-investment-treaties.

[10] Anyone who still thinks that common law countries have to follow precedent while civil law countries don't, and anyone else who wants to learn about excellent legal argument, is strongly recommended to read Frank Emmert, *Stare Decisis: A Universally Misunderstood Idea*, Legisprudence - the Theory and Practice of Legislation, Vol. 6, No. 2, pp. 207-227 (2012), available for free at https://www.researchgate.net/publication/256018485_Stare_Decisis_A_Universally_Misunderstood_Idea.

For a more general summary on how to analyze facts and law and write a persuasive legal brief see also Frank Emmert, *Section 5: How to Analyze a Case in an Exam and in Practice*, in Frank Emmert, *International Business Transactions – Text, Cases and Materials*, pp. 53-69, available at https://www.researchgate.net/publication/319477671_The_General_Framework_for_International_Business_Transactions.

rendered in investor-state arbitrations are usually made public because of the significant public interest, both in the home and hosts state. The best open access collections of ISDS case law are provided by ICSID,[11] UNCTAD,[12] and Prof. Andrew Newcombe of the University of Victoria.[13]

Finally, in analogous application of Article 38 of the Statute of the International Court of Justice (ICJ), “the teachings of the most highly qualified publicists of the various nations” can be consulted “as subsidiary means for the determination of rules of law” relevant for international investment protection. There are multiple ways of accessing academic and professional publications online for anyone who does not have access to a well-stocked public- or university library and/or pay-for-play databases like HeinOnline, JStor, Westlaw, or Lexis. An excellent overview is provided by Georgetown Law Library.[14] The Council on International Law and Policy (CILP) is developing a bibliography with an emphasis on open access literature.[15] Most useful for most online literature research, however, will still be Google Scholar,[16] since it will bring up not only general and institutional websites but also publications openly accessible via SSRN, ResearchGate, Academia.edu, and the websites of individual university departments and faculty members.

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11 https://icsid.worldbank.org/cases/case-database.

12 https://investmentpolicy.unctad.org/investment-dispute-settlement.

13 https://www.italaw.com/.

14 https://guides.ll.georgetown.edu/InternationalInvestmentLaw.

15 https://www.cilpnet.com/p4-investment-law-literature.

16 https://scholar.google.com/.