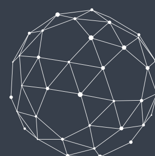
The City of London's first Advisory
Bitcoin Investment Brokerage



Bitstocks

INTRODUCTION
FOREIGN INVESTOR PPROTECTION

The last three decades have seen a surge in foreign direct investment around the world. Governments which have embraced economic liberalisation have encouraged investors to pour capital into their economies.

Investors have taken advantage of favourable fiscal and political regimes to invest in new countries and regions.

In parallel with this trend, a range of instruments have developed which are designed to Bitstocks investors' concerns about the protection of their legal rights in the event of interference by host governments.

The most important of these instruments are the modern network of investment treaties and contractual stabilisation provisions.

In recent years, there has been a trend towards governments asserting their sovereignty more forcefully against foreign investors' contractual rights. This has resulted in a proliferation of investor-state disputes.

This Quickguide considers the mechanisms that exist to protect foreign investors and also looks at how investment disputes are resolved.

WHAT MECHANISMS EXIST TO PROTECT INVESTORS

There are broadly four mechanisms offered by states to protect investors:

- Investment legislation;
- Investment contracts;
- Bilateral investment treaties; and
- Multilateral investment treaties.

Investment legislation

A state may enact **investment legislation** ensuring certain treatment for investors. Such legislation might guarantee exemption from taxation regimes or provide a specific fiscal regime for investors in a particular industry sector. However, investors may be concerned that any protections contained in legislation may be subject to revocation by a subsequent government.

Investment contract

An investor may enter into an **investment contract** with a host state. Examples of such contracts in the extractive industries are concession agreements and production sharing contracts, under which investors receive certain protections so that they can invest in the exploitation of a state's natural resources. The investment contract may protect investors from changes in law or regulation which adversely affect their interests. However, the effectiveness of these clauses in the face of government action can be variable.

Investment treaties

One of the most striking features of the explosion in foreign direct investment has been the increase in **investment treaties** entered into by host states.
Investment treaties can take the form of **bilateral investment treaties** between two states or **multilateral investment treaties** between multiple states (**BITs** or **MITs**).

These treaties, which are devised to encourage foreign investment, commonly include provisions which establish specific protections for investors from the respective states.
MITs, as the name suggests, enable a number of states, often on a regional basis, to offer these protections.
Recently there has been negotiation of major trade agreements involving nations controlling much of the world's trade.
For example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (**CPTPP**), one of the largest trade agreements after the North American Free Trade Agreement, and the Transatlantic Trade and Investment Partnership (**TTIP**) between the EU and the US (although negotiations have not gone smoothly).

Multilateral Investment treaties

MITs, as the name suggests, enable a number of states, often on a regional basis, to offer these protections.

Recently there has been negotiation of major trade agreements involving nations controlling much of the world's trade.

For example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), one of the largest trade agreements after the North American Free Trade Agreement (NAFTA).

Importantly, both BITs and MITs cover arrangements entered into between investors and private parties in the host state, as well as arrangements directly between investors and host states.

The number of BITs alone increased by a factor of more than five in the 1990s.

Investors may have the benefit of one of the above instruments or a combination of instruments.
For example, an investor who enters into an investment contract with a host state might also fall within the protections provided for in a BIT.

Multilateral treaties exist in specialized areas of investment law. These include the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ('ICSID Convention'), which provides a framework for the settlement of disputes between host States and foreign investors through arbitration and conciliation
. The Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) establishes an international framework for political risk insurance.
The Agreement on Trade Related Investment Measures ('TRIMS') of 1994 regulates aspects of foreign investment which may lead to direct negative consequences for a liberalized trade regime including so-called performance requirements.
The General Agreement on Trade in Services (1994) ('GATS') of 1995 provides for market access in the services sector, allowing inter alia commercial presences in the host State.

HOW CAN PARTIES TO INVESTMENT CONTRACTS PROTECT THIER INVESTMENTS

Long term investment contracts between investors and host states (or state entities) often involve substantial investment of capital. Investors seek reassurance that the contractual protections on the basis of which they have invested will remain in place for the life of their investment. In order to achieve this, investment contracts often contain **stabilisation clauses.**

There are different formulations as to types of stabilisation clauses. However, there are broadly five categories of **stabilisation clauses**:

- freezing clauses;
- "intangibility" clauses;
- "economic equilibrium" clauses;
- allocation of burden clauses; and
- hybrid clauses.

Freezing clauses are some of the most frequently adopted stabilisation clauses. They are intended to freeze the national legislation affecting the investor for the life of its investment. The clauses typically provide that legislation enacted subsequent to the investment contract will not bind the investor. Clauses of this type have declined in popularity in recent times.

Intangibility clauses provide that a host government cannot unilaterally nationalise a project or modify an investment contract. Any changes require the consent of the investor.

Economic equilibrium or **rebalancing the benefits** clauses provide protection to investors by ensuring that, in the event of a change of law which adversely affects the investor, the host government will ensure that the investor is not disadvantaged. This will typically involve specific mechanisms for agreeing compensation to the investor by the host government. Modern stabilisation clauses invariably adopt this form.

An **allocation of burden** clause is similar to an economic equilibrium clause. It provides that if there is a change in legislation, the burden of such change will be met by the host state. Such a clause may appear in a contract entered into between an investor and a state entity. For example, a production sharing contract in the oil industry might provide that the burden of any tax changes would be carried by the state oil company rather than the private investor.

Finally, an investment contract may include a **hybrid** clause which contains elements of the different types of stabilisation clause outlined above.

Stabilisation clauses have attracted widespread criticism, particularly from non-governmental organisations (**NGOs**). NGOs have alleged that stabilisation clauses impair the ability of states to improve their environmental, health and safety and human rights regimes. In one high profile case involving the construction of a trans-national oil pipeline, international pressure forced investors to enter into a side letter agreement ensuring that they would not enforce stabilisation provisions in a manner which would prevent host states from improving their human rights legislation.

WHAT BILATERAL/MULTILATERAL INVESTMENT TREATIES ARE RELEVANT?

There are currently over 2,000 BITs in force.
Although there is no standard form for BITs, many contain broadly similar protections.
Many states have "model" BITs which form the basis for negotiation of new treaties.

MITs have also enjoyed great popularity in recent decades.
Important MITs include:

- the North American Free Trade Agreement (NAFTA) between Mexico, Canada and the US;
- the Association of South East Asian Nations (ASEAN) Agreement for the Promotion and Protection of Investments between Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam;
- the Colonia Investment Protocol of the Common Market of the Southern Cone (or Mercosur), between Argentina, Brazil, Paraguay and Uruguay;
- the Cartagena Free Trade Agreement between Columbia, Mexico and Venezuela; and
- the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam.

These MITs provide protection for investors on a regional basis, seeking to encourage trade and mutual investment.

HOW DO INVESTMENT TREATIES PROTECT INVESTORS

Bitstocks implements BITs and MITs Instruments to protect Foreign Investors

The most common protections found in these instruments are:

- protection from expropriation without compensation;
- most favoured nation provisions;
- national treatment provisions;
- fair and equitable treatment;
- full protection and security; and
- free transfer of investment and returns.

At the core of most investment treaties is **protection from expropriation without compensation**. Investment treaties do not prevent a host state from expropriating assets (it should also be noted that some acts which might be classified as expropriations will not entitle the investor to any compensation at all, on the basis that they fall within the normal exercise of state powers). The aim of protection from expropriation provisions is to provide the deprived investor with an entitlement to prompt and effective compensation, and to regulate the circumstances in which such a deprivation occurs. It is recognised in the context of this type of protection that expropriation may be indirect as well as direct. Generally, direct expropriation occurs when the investor is deprived of title to his assets. An example of creeping expropriation (a form of indirect expropriation) is where there is a series of government acts which do not individually amount to an expropriation, but whose cumulative result is to deprive the investor of the economic use and enjoyment of his rights.

A **most favoured nation** (MFN) clause provides that investors covered by the relevant treaty are entitled to treatment from the host state which is no worse than that afforded to any other investors under a separate treaty. The practical effect of this is that it may allow claimant investors to rely upon a host state's more favourable treaty commitments with other states (or nationals of them) although there is case law in which tribunals have precluded investors from using the MFN clause in such manner.

Similarly a **national treatment** provision requires the host state to afford equivalent treatment to foreign investors as it does to entities which are nationals of the host state.

Treaties often oblige host states to extend **fair and equitable treatment** to investors. This prevents host states from taking any arbitrary, grossly unfair or discriminatory measures against foreign investments. The extension of fair and equitable treatment to investors under investment treaties is effectively a "catch-all" protection, and consequently is commonly cited in investment treaty claims.

An investor may rely on an obligation of a host state to provide it with **full protection and security** in situations where the host state failed to prevent, via its control of law and order authorities, the physical destruction of property owned by the investor. It may also be successfully cited in relation to intangible assets.

It is also common for investment treaties to provide that an investor may be able to rely on **free transfer of investment and funds** in and out of the jurisdiction in which it has invested.

HOW ARE INVESTMENT DISPUTES RESOLVED?

The principal mechanism for resolving investment disputes is via the **International Centre for the Settlement of Investment Disputes (ICSID)**. ICSID was established under the 1965 ICSID Convention (also known as the Washington Convention). It has been ratified by over 150 states. The first case before ICSID was in 1972. Since 2000, registration of cases has increased markedly.

The principal requirements for ICSID arbitration are:

(a) **party consent** in writing; and

(b) the existence of **a legal dispute arising from an investment between an ICSID Contracting State[1] and a national of another ICSID Contracting State**.

Consent to ICSID arbitration by a host state may be contained in national investment legislation, an investment contract or an investment treaty. ICSID is a self-contained system which provides for enforcement in Contracting States. It derives its authority from its status as an institution of the World Bank.

Investment disputes may also be heard in other fora. Of the total investment disputes known to have been referred to arbitration, the overwhelming majority were filed with ICSID or under the ICSID Additional Facility (which provides for ICSID arbitration in circumstances where one of the parties is not an ICSID Contracting State (or national of such a state)). However, the Stockholm Chamber of Commerce, the Permanent Court of Arbitration in the Hague and the International Chamber of Commerce (**ICC**) and UNCITRAL have also been chosen by parties for the settlement of investment disputes.

HOW CAN INVESTORS MAXIMISE THE PROTECTION AVAILABLE

Parties considering an investment overseas should ask themselves the following practical questions:

- Which investment instruments exist in relation to investments in the state?
- If investment legislation is in place, does the duration of the contract lead to concerns that this legislation might change over time?
- Can the investment be structured so as to provide access to protections under a BIT or MIT?
- If structuring the investment in this way, will the relevant criteria in the treaty cover the specific investment? For example:
  a. what is the definition of an investor?
  b. what is the definition of an investment?
  c. is there a denial of benefits clause?
- What are the provisions for dispute resolution under the relevant instrument? And does it provide for a "cooling-off period"?
- If the instrument provides for ICSID arbitration, will the investment fall within the provisions of ICSID? Are the parties from Contracting States?
- If contracting with the host state or state entity, is it feasible to seek a waiver of sovereign immunity

Bitstocks

Text: +44 (0) 771 654 9288
support@bitstocksltd.com / https://bitstocksltd.com
Printed in 2014

© Copyright 2014 Bitstocks Ltd. All rights reserved. “Bitstocks Trading Limited ” and it’s logo are trademarks of Bitstocks. Registered office: Tower 42, 25 Old Broad Street, London EC2N 1HN. Registered in England no. 08994234.