

Mechanisms of Seeking War Damage Compensation for Foreign Direct Investment

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Abstract: Foreign investors might suffer loss to their overseas investment resulting from war or armed conflict, and thus raise the issue of seeking war damage compensation. Under the international legal system, foreign investors could resort to diplomatic methods and legal methods for claiming war damage compensation. Some of these diplomatic methods, commonly represented by negotiation and mediation, are incorporated in a vast number of BITs. Using diplomatic methods allows a certain degree of flexibility but they cannot guarantee any outcomes. Instead, foreign investors could resort to legal methods, which include litigation and investment arbitration. Litigation before domestic courts imposes the obstacles of state immunity and other preliminary requisites for foreign investors. Investment arbitration, regarded as a major measure of resolving international investment-related disputes, provides foreign investors an effective forum for seeking war damage compensation. Yet foreign investors should be aware that arbitral tribunals might exercise different standards on the host state's obligations and valuation of investment losses.

Keywords: Foreign investment, war, war damage compensation, mechanism.

1. Introduction

Arriving in the 21st century, cross-border investments have boosted to a new high level ever in human history. Without the need for reference to statistics, ordinary people are associated with foreign direct investment ("FDI") in daily life in a manner that they cannot even realise. Yet it is also since the 21st century, regional wars have occurred more ever in terms of number and scale ever than those in the last few decades of the 20th century. In an era where FDI and regional wars co-exist, one question naturally arises: through what mechanisms could foreign investors seek damage compensation if their investments suffer loss in war time, especially when such loss has resulted from the invading state.

Academics have already produced substantive literature in relation to this question. Shortly after the world war II, Nehemian Robinson introduced schemes of war damage compensation and restitution available in dozens of European countries under their respective domestic law [1]. Although mechanisms of foreign investment protection has evolved to new dimensions nowadays, Robinson's work has inspired a domestic pathway for war compensation. Christoph Schreuer analysed protection and remedies for foreign investors under international investment law, mainly bilateral investment treaties ("BIT") by referring to several cases of the International Centre for Settlement of Investment Disputes ("ICSID"), and concluded that protection for foreign investors is far from uniform and dependent on each specific BIT [2]. Some scholars focus on more precise

aspects of damages compensation of FDI. Among them, Francesco De Santis presented the Italian courts' opinion on effective remedies for war damage against state immunity [3]. In general, most of these articles undoubtedly delivered extensive studies on selected mechanisms of seeking war damage compensation of FDI.

Settling war damage compensation in essence is about resolving disputes between foreign investors and relevant state parties. Under international legal regime, the mechanisms of dispute settlement include negotiation, mediation, inquiry, conciliation, litigation and investment arbitration, with the former four collectively referred to as diplomatic methods, and the latter two collectively referred to as legal methods [4].

Rather than focusing on one specific mechanism, this article summarises contemporary practices of seeking war damage compensation by foreign investors under each available mechanism. While analysing the underlying questions of legal grounds, this article also presents the major obstacles that foreign investors face when using each mechanism. For the ease of understanding, this article is based on this hypothetical scenario: a foreign investor built in the host state a factory, which constitutes a FDI as defined in most BITs, and this factory was then completely destroyed during a war initiated by an invading state against the host state within the territory of the host state, causing economic loss to the investor, and the invading state was found responsible for the act of destroying investor's factory.

2. Diplomatic Methods of Seeking War Damage Compensation

As introduced above, diplomatic methods include negotiation, mediation, inquiry and conciliation. Oftentimes, diplomatic methods are called alternative dispute resolution ("ADR"). It should be noticed that many treaties and other instruments permit parties involved to settle investment disputes through ADR mechanisms and the process of ADR may generally be commenced at any stage by agreement of the parties [5], even when legal methods have already been employed. If amicable settlement is achieved during an ICSID arbitration proceeding, relevant results could be incorporated into an ICSID arbitral award, making it binding and enforceable among parties [6].

Negotiation is the direct interaction between disputants by exchanging their interests and proposals. It could be conducted in the least formal manner and freely available to parties at any time under the control of parties involved. Negotiation, however, could be designated as a mandatory prerequisite of investment arbitration. During the preparation of this article, the author reviewed 5 recently signed BITs (and coincidentally all not in force) as available on UNCTAD website and found that 3 ones among those 5 BITs require negotiation as the first stage of dispute settlement, absent from which parties in dispute are not permitted to initiate arbitral proceedings [8,9]. The other 2 BITs reviewed, though not requiring mandatory negotiation, do recommend ADR still.

Mediation, another ADR mechanism, to a large extent could be regarded as negotiation with facilitation of a third party. According to an ICSID study in 2021, over the past 25-30 years, BITs have seen a gradual trend to expressly incorporate mediation clauses, along or in conjunction with other ADR mechanisms, into their dispute resolution provisions [9]. Similar to negotiation, mediation contained in BITs varies that it could be optional, encouraged or mandatory.

In addition to the requirement of negotiation or mediation, modern BITs usually provide normative process with respect to how negotiation or mediation should be conducted. Therefore, foreign investors should resort to negotiation or mediation in compliance with procedural requirements as set in underlying BITs, including but not limited to the format of notice, designated agency service, time limits for initiation, settlement period available, and other procedural issues as required.

The other two ADR methods, inquiry and conciliation, to the author's knowledge, are less employed in the context of seeking war damage compensation and other types of investment disputes. As Merrills provides, inquiry in a broader sense refers to the process performed whenever a court or

other body attempted to resolve a disputed issue of fact, and conciliation is a method for the settlement of international disputes according to which a commission set up by the parties to deal with a dispute on an impartial basis [4]. Inquiry and conciliation both embodies an obvious institutional feature as they require assistance of third-party institution, whether court of commission. This formality feature indicates that inquiry and conciliation are perhaps more suitable for disputes between sovereign states, rather than investment disputes including seeking war damage compensation, which flexibility and economic benefit would be more appreciated.

3. Legal Methods of Seeking War Damage Compensation

Amicable diplomatic methods do not always guarantee a satisfactory outcome, and in case where war damage compensation could not be obtained via negotiation or mediation, foreign investors would then resort to legal methods, namely litigation and investment arbitration.

3.1. Litigation

First of all, foreign investors may submit their claim for war damage compensation before the court of the host state against the invading state. Initiation of such claims are usually free from other pre-action as, to the author's knowledge, domestic procedural laws seldom place prerequisites on filing a claim. Such claims, however, will inevitably encounter the defence of state immunity. State immunity is a principle of customary international law, by virtue of which one sovereign state cannot be sued before the courts of another sovereign state without its consent [10]. A chief facet of the question of state immunity is about jurisdiction that the court should already have jurisdiction to speak of immunity or exemption from it [10]. The court of the host state shall have jurisdiction to hear the claim of seeking war damage compensation based on both the territorial principle and nationality principle, as the act in war time causing damage occurred within the territory of the host state and damaged property usually owned by a foreign-invested entity incorporated under the laws of the host state.

Nowadays, two doctrines of state immunity are adopted by modern states: the absolute doctrine and the restrictive doctrine. Under the absolute doctrine any proceedings against foreign states before domestic courts, while under the restrictive doctrine immunity is only available if the state's action is of sovereign nature rather than commercial nature. In any sense, acts of war are undoubtedly of sovereign nature. As such, unfortunately, damage to foreign investment resulting from action of the invading state falls into arena of both state immunity doctrines.

Regarding recent application of state immunity, it is worthy noticing that the Italian court held the opinion in several decisions that if war actions constitute serious violation human rights law, it could cautiously deny the application of state immunity [3]. Yet whether this standpoint could spread to other domestic courts and extend to the field of claiming war damage compensation would have to be seen in further future.

On the other hand, foreign investors could choose to submit their claim to the domestic court of the invading state. Such action avoids the jurisdictional barrier of state immunity as generally in modern society within one jurisdiction government is not exempted from its parallel judiciary authority.

Notwithstanding the above, legal grounds of the claim remain a preliminary question that faces the claiming foreign investor: to support its claim, should foreign investors invoke the domestic laws, probably the law of tort of the invading state, or BIT between the host state and the invading state, or BIT between the home state of foreign investor and the invading state, or even customary international law such as responsibility for state's wrongful acts? One could presume that each of

these solutions would encounter theoretical and practical obstacles in the scenario presumed in this article.

Whichever legal grounds, there usually exist certain requirements on the application of that law therein. Such requirements normally include territorial scope, proper parties to the action and capacity of persons. In light of these requirements and given the intertwined characteristics of foreign investment and sovereign wars, domestic law of the invading states, as well as possible BITs, may be found not inapplicable. As for customary international law, the attitude and acceptance of courts of the invading state plays a key part so that, at least to the author's knowledge, no universal guidelines or standards have been available to foreign investors to rely on as supporting legal grounds.

3.2. Investment Arbitration

According to UNCTAD's statistics, by the end of 2021, the total number of existing BITs in the world is 2794 (among which 2227 BITs have been in force), covering over 160 signatory states worldwide. Most of these BITs include arbitration, whether institutional or ad hoc as mechanism of dispute resolution, and in fact by the time of this article arbitration has been much prevailing over litigation in settling investment disputes [11].

One of the underlying grounds that foreign investors frequently invoke under BITs is that, as contained in most modern BITs, provision of full protection and security by host states is demanded. Full protection and security means that "the host state is under an obligation to provide some measure of protection against forcible interference by private persons [and] by State organs such as police and the armed forces"[12]. Thus, in the presumed scenario that the foreign investor's factory is damaged due to the act of the invading state, the simple fact that property is destroyed already indicates that the host state fails to perform its obligation of full protection and security. In addition to full protection and security as a treaty-law obligation, some ICSID awards even found that such obligations fall into the regime of customary international law [13]. Analysis of several ICSID cases further found that investor protection in times of armed conflict will in large measure depend on the availability of favourable treaties and the current situation is far from uniform that the degree of protection varies across jurisdictions [4].

Despite the obligations imposed on host states under BITs, the issue of compensation has not received adequate attention. Though the basic principle that "the responsible [s]tate is under an obligation to make full reparation for the injury caused by the internationally wrongful act" is adopted as a prevailing standpoint by majority tribunals, arbitral jurisprudence on compensation is in fact inconsistent among tribunals [14]. An example of such inconsistency could be that different tribunals might not share the same view regarding what items of damages should be compensated and might adopt distinct measures of damages valuation. In addition to this inconsistency, standards of compensation are diverse under different BITs. For example, a study on the region of the Middle East and North Africa ("MENA") indicates that the compensation principles applicable in the context of a claim against a MENA state arising out of an armed conflict will [...] largely depend on the underlying treaty" [15].

If foreign investors successfully obtains favourable ICSID awards ordering provision of war damage compensation, it is entitled to seek recognition and enforcement pursuant to ICSID Convention and all ICSID member states are bound by ICSID awards. However, ICSID itself has no coercive power to guarantee recognition and enforcement of ICSID awards, and member states' domestic law in relation to state immunity from execution will continue to apply pursuant to article 55 of the ICSID Convention [16]. Albeit these intrinsic defects of ICSID system, foreign investors might find inspiration from Ukrainian Supreme Court's practice in the Everest case. In this case the Ukrainian Supreme Court denied Russia's state immunity from execution and ruled that the power to determine what property constitutes property of Russia belongs to the courts of Ukraine and upheld

inferior courts' decision to seize certain Russian banks' property for the sake of enforcement of arbitral awards in relation to damages occurred in Crimea Conflict.

4. Conclusion

The rights for compensation or reparations for war damages are recognised under international law and domestic law, and if an investor's rights are infringed during an armed conflict, it is entitled to get compensation for the loss resulting from the violation [17]. In recent years, especially since the Crimea Conflict in 2014, there has been a visible trend that foreign investors are getting more proactive in seeking war damage compensation. Although under contemporary international law system various well-designed mechanisms are available to foreign investors to claim war damage compensation, none of these mechanisms have been proven easy and pro-investor as analysed above. This suggests that foreign investors should thoroughly evaluate and take proper measures in seeking war damage compensation.

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