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SYMPOSIUM ON INSTITUTIONALIZING INVESTMENT DISPUTE PREVENTION

INVESTMENT RETENTION MECHANISMS: RATIONALE AND IMPLEMENTATION EXPERIENCE

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Introduction

This contribution highlights the importance of institutional dispute prevention not just to prevent the proliferation of formal legal disputes between states and foreign investors, but also to preserve the relationship between investors and states and enable investment retention and expansion. Drawing from empirical studies and survey findings, as well as the World Bank's country experience of working on investment policy and promotion frameworks, this contribution provides an overview of the World Bank's experience in implementing such mechanisms globally.[1]

Countries are facing increasingly fierce competition to attract, retain, and expand foreign direct investment (FDI). Dispute prevention has received much attention in the last few years as a way to reduce investor-state dispute settlement (ISDS) cases. However, the benefit of dispute prevention mechanisms extends beyond ISDS prevention alone. Issues causing ISDS also impact the continuity of investment operations. Research shows that political risks dampen FDI.[2] Survey data complements these empirical findings: according to the 2019/2020 Global Investment Competitiveness Report,[3] two-thirds of survey respondents would consider withdrawing their investment or canceling a planned investment in a country in response to irregular government conduct. Specifically, expropriation, lack of transparency and predictability in dealing with public agencies, delays in obtaining the necessary government permits to start or operate a business, and sudden, adverse regulatory changes were reported as the top reasons for FDI withdrawals and cancellations (of expansion plans).[4] The inability to retain

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[1] This essay is based on the World Bank's experience implementing retention mechanisms globally. Such mechanisms may be referred to by different names, such as grievance mechanism, dispute prevention mechanism, ombudsman, or aftercare services. These mechanisms may focus on prevention of disputes (as is the case in most "grievance mechanisms") or retention and expansion of investment (mostly in "aftercare programs") or both.

[2] Sarah Hebous, Priyanka Kher & Trang Thu Tran, *Regulatory Risk and FDI*, *in* World Bank, Global Investment Competitiveness Report 2019/2020: Rebuilding Investor Confidence in Times of Uncertainty 128 (2020); Priyanka Kher & Dongwook Chun, Policy Options to Mitigate Political Risk and Attract FDI: In Focus: Finance, Competitiveness, and Innovation (World Bank, 2020).

[3] World Bank, *supra* note 2; World Bank, Global Investment Competitiveness Report 2017/2018: Rebuilding Investor Confidence in Times of Uncertainty (2018).

[4] While not squarely relevant for "dispute prevention," there is an additional set of issues arising in operations of investors (often referred to as "operational risks"), that can affect investment retention. *See* Priyanka Kher & Griffin Carlos, Divestment Drivers and FDI Retention

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existing investment and encourage existing investors to expand, can be a setback for developing countries in particular, as approximately 40 percent of FDI globally is in the form of reinvested earnings.[5] Indeed, continuity of investment is important to diversify and generate FDI spillovers, which require sustained infusion of knowledge and technology from foreign parent firms.[6]

Can Investor Issues Be Resolved Effectively in a Non-litigious Way?

International Center for Settlement of Investment Disputes (ICSID) caseload statistics have consistently shown that about 30 percent of registered investment disputes are settled.[7] Earlier research on ICSID cases between 1970 and 2012 found that almost 40 percent of the total settlements took place during what the authors called "Phase 1" of the arbitration proceedings—that is, between the time the arbitration was registered and the constitution of the tribunal.[8] The research also found that the most common type of settlements were made on agreement between the parties (pursuant to Rule 43(1) of ICSID's Rules of Procedure for Arbitration Proceedings) and not for reasons of failure to act, non-payment, and so on. The political economy of disputes is complex and not the focus of this essay. But the research highlights that in such contexts, explicit agreements were reached among the parties, governments were recognizing that a negotiation with the investor had taken place, and that a "mutually accepted solution" to the dispute had been reached. This suggests that a resolution prior to escalation into legal disputes is possible, where investors and host countries are able to engage in a timely way and with knowledge of possible implications of the law.

Building on this, World Bank research has shown that countries have been taking initiatives to address investor issues in different ways and at different stages.[9] Investor issues can be distributed along a spectrum—an "investor-state conflict continuum."[10] At one end of the spectrum is a state of agreement between the state and the investor, immediately adjacent to this are relatively minor disagreements, with the spectrum then ranging through to fully fledged disputes. Investor issues that begin as relatively minor disagreements, placed at the initial phase of the spectrum, can progressively evolve into full-fledged legal dispute at the other end of the spectrum. Until recently, countries predominantly focused on the two ends of spectrum—that is, on minor problems during the establishment of an investment or on full-fledged legal disputes. Investor issues during the establishment of investment were usually addressed by aftercare programs within investment promotion agencies.[11] In contrast, formal investor-state disputes were managed or coordinated by dispute management agencies tasked with organizing the state's defense. The experience of some countries has demonstrated that most states had not adopted measures to address the middle of the spectrum—where investor issues were festering, but had not yet developed into legal disputes though they had strong potential to become one. Moreover, these issues were increasingly having an impact on the continuity of the investors' operations.

(World Bank, 2023). Investment retention mechanisms can address issues of political risk (with a more direct link to dispute prevention), or operational risk, or both.

[5] Organisation for Economic Co-operation and Development, FDI Flows in time of COVID-19 (2020).

[6] Beata Javorcik & Steven Poelhekke, *Former Foreign Affiliates: Cast Out and Outperformed?*, 15 J. Eur. Econ. Ass'n 501 (2017)

[7] ICSID, ICSID Caseload – Statistics (2024).

[8] Roberto Echandi & Priyanka Kher, *Can International Investor–State Disputes be Prevented? Empirical Evidence from Settlements in ICSID Arbitration*, 29 ICSID Rev – For. Inv. L.J. 41 (2014).

[9] World Bank, Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses (2019).

[10] Roberto Echandi, *Investor-State Conflict Management: A Preliminary Sketch*, 11 Transnat'l Disp. Mgmt. (2014); World Bank, *supra* note 9.

[11] Aftercare programs refers to specific services provided to investors to address problems in establishment and operations (for example, hastening a visa process or connecting with local suppliers).

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Investment Retention Mechanisms: Evolving Design and Priorities

Drawing lessons from the empirical and survey findings discussed above, effective national institutions and the World Bank's country experience working on investment policy and promotion frameworks, the World Bank, in consultation with various countries, has helped develop models for investment retention mechanisms. The elements and details of retention mechanisms provided in this essay are based on the experience of the World Bank over the past few years supporting implementation of retention mechanism globally.[12] The descriptions reflect best practices drawn from a range of possible models that have been adopted by states. The diffusion of these mechanisms has been in response to a variety of country objectives, including to: (1) improve retention and expansion of FDI; (2) reduce the possibility of investor-state disputes; and (3) implement specific provisions of investment agreements.

Framework and Key Elements of Retention Mechanisms

Retention mechanisms enable governments to identify, track, and resolve investor issues affecting established investors in a timely manner. They target investor issues that may put investment projects at risk of divestment (or may risk the cancellation of expansion plans) or which entail a risk that the host state will be found liable under applicable domestic or international investment rules.

Conceptually, the World Bank's work on investment retention mechanisms aims to address a few gaps that cause investor issues in the first place. First, there is often information asymmetry between the officials within the government signing international investment agreements, making policy and law, and those that engage with investors on a day-to-day basis.[13] Second, there are inconsistencies in institutional priorities and poor coordination on matters affecting investment. Third, governments do not have tools to detect investor issues in time, often discovering such issues when it is too late to remedy them. Fourth, governments often fail to establish clear processes to guide the handling of investor issues. Lastly, investor issues, their implications, and results of successful resolution are not systematically monitored.[14]

Experience from World Bank projects to date suggests that while the design and implementation of retention mechanisms should be adapted to the specific needs of a given country, there are some elements common to successful retention mechanisms (addressing the gaps above). These elements, derived from a review of the World Bank's project implementation experience and country examples, are: (1) an effective institutional set up; (2) clear operating procedures; and (3) a monitoring and evaluation framework.[15]

(1) Institutional Set Up: Having an appropriate institutional set up can entail at least three core elements: (1) establishing a lead agency in charge of coordinating the functioning of the retention mechanism; (2) adopting a legal instrument to empower the lead agency and to clarify its mandate; and (3) identifying a forum or platform to escalate investor issues as needed, where political decision making or advocacy is required.

The lead agency may either be newly set up or an existing agency may be allocated the mandate. Countries have chosen both models. Some have established a new independent lead agency such an ombudsman, as in the case of

[12] *See* World Bank, *supra* note 9; Priyanka Kher, Eloise Obadia & Dongwook Chun, Managing Investor Issues Through Retention Mechanisms (World Bank, 2022); UNCITRAL, Possible Reform of Investor-State Dispute Settlement: Draft Guidelines on Prevention and Mitigation of International Investment Disputes, UN Doc. A/CN.9/WG.III/WP.235 (Nov. 20, 2023).

[13] This information asymmetry may be regarding investment policies of the country or with respect to information about the rights and obligations of investors under the laws of the country.

[14] Echandi, *supra* note 10; World Bank, *supra* note 9; Kher, Obadia & Chun, *supra* note 12.

[15] World Bank, *supra* note 9; Kher, Obadia & Chun, *supra* note 12.

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Brazil or Georgia, while others have strengthened an existing agency (such as the investment promotion agency) to perform lead agency functions, as seen in Rwanda or Vietnam.[16] The agency should have well-trained staff, who understand investment operations and technical legal and economic implications of investor issues, and who possess strong negotiation and advocacy skills that enable them to deal with peer agencies.

Within the typology discussed in this symposium, retention mechanisms' core function is early detection and resolution of investor grievances (prior to their escalation into legal disputes). Toward this goal, the lead agency plays the role of both ensuring consistent monitoring and communication with investors to identify grievances at an early stage, and identifying sensitive and strategic sectors where such grievances might arise. Apart from resolving the investor grievance, one important contribution of the lead agency is detection of systemic issues (i.e., issues faced by a broader set of investors and requiring a specific legal or regulatory reform). Investors can report their grievances directly to the lead agency. While the lead agency may be housed in a single agency, retention mechanisms typically involve the participation of many agencies playing a variety of roles. For instance, an escalation body is needed, where the lead agency is unable to reach a solution or for additional political endorsement. Such a political decision-making body typically already exists (e.g., cabinet or an inter-ministerial body), but is leveraged for the purpose of escalating specific investor issues.

(2) Operating Procedures: Operating procedures can guide government staff on the steps and requirements of a retention mechanism's process. Experience from World Bank projects suggests that a typical process involves six steps: (1) registration of the issue; (2) filtering of the issue to determine if it falls within the scope of lead agency; (3) legal and economic assessment; (4) problem solving; (5) escalation where needed; and (6) monitoring and follow up for implementation of solution.[17]

These steps are not isolated; stakeholder engagement in projects have highlighted, for instance, that legal and economic assessment can help in problem solving. Such an assessment may also reveal additional social and environment implications of the underlying issue, such as disruption in a public service, environmental implications, etc. Effective problem solving may be a result of peer pressure, rules-based negotiation, interest-based negotiations, or power-based negotiations.[18] If the lead agency is unable to resolve the issue due to a lack of cooperation by other agencies or because the underlying issue is too politically sensitive, then the lead agency can escalate the issue to a higher political level.

(3) Monitoring and Evaluation: Agencies often find it difficult to follow up on solutions and showcase their results within the government. Proactive monitoring can address these challenges. Countries have utilized such measurements as the number of issues resolved, or investment and jobs (or number of projects) retained or expanded to measure performance.

Variations in Implementation: Driven by Country Priorities[19]

The above section presented common features of successful mechanisms. But it is important to note that ultimately, a high level of flexibility needs to be maintained and significant variations may be needed to respond to country realities and priorities. For example, in terms of lead agency set up, while Rwanda empowered the Rwanda Development Board to perform dispute prevention functions, Brazil established a new Direct Investment Ombudsman. Structural variations have implications on the functioning, but not necessarily the success, of the

[16] World Bank, *supra* note 9; Kher, Obadia & Chun, *supra* note 12; UNCITRAL, *supra* note 12.

[17] World Bank, *supra* note 9; Kher, Obadia & Chun, *supra* note 12, at 11.

[18] Interest based negotiations are driven by finding common interests to solve a problem, while rules- and power-based negotiation rely more on prescribed rules and established power structures respectively.

[19] Even the naming of the mechanism has varied. *See* note 1 and accompanying text *supra*.

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mechanism.[20] Locating a lead agency within an existing, appropriately empowered investment promotion agency may allow for better access to investors, but may not be viewed as independent or powerful enough to serve as a check on government overreach when compared to an independent ombudsman.

There may also be variations in the core objective across retention mechanisms. For example, in certain countries, the focus of the retention mechanism may be on retention and setting up strong aftercare programs—with dispute prevention being an additional benefit. This was the case of the Korean Trade-Investment Promotion Agency (KOTRA), which has only recently signed a memorandum of understanding with the Ministry of Justice to establish a more timely means of communication between them, in order to prepare for potential disputes.[21] On the other hand, other mechanisms may focus more on dispute prevention. There may also be differences in the main beneficiaries of retention mechanisms. While some countries may limit access of retention mechanisms to foreign investors, others may make them available to domestic firms as well.

Lead agencies may also play a role in facilitating settlement agreements when a dispute is brought to court or arbitration. The scope and number of functions adopted by a retention mechanism should reflect the capacity and resources of the lead agency, so that goal of retention and dispute prevention is not diluted.

Recently, investment agreements have begun to incorporate provisions requiring signatory states to establish a dispute prevention or retention mechanism, or a national focal point. Examples of this practice include the Regional Comprehensive Economic Partnership Agreement, the Investment Protocol of the Agreement on Africa Continental Free Trade Area, and the World Trade Organization's Investment Facilitation for Development Agreement. In such circumstances, countries often link the creation of a retention mechanism, and the design of its parameters, to the implementation of these agreements.

Lastly, it is important to note that not all investor issues can be resolved or even need to be resolved.[22] Indeed, in some cases, it is best to seek the resolution of an issue though dispute settlement mechanisms, in others, divestment (including cancellation of expansions) is a better outcome for host states than keeping an investment. This determination is an important one, and something that the lead agency also needs to make in determining its approach toward specific investor issues.

Areas for Further Adjustments

With evolving technology, the emergence of new business models, and changes in the political economy around investment in developing countries, retention mechanisms will need to be further refined. For example, such mechanisms will increasingly need to consider sectoral specific design. Recent research shows that certain sectors, such as renewable energy, can be especially vulnerable to political and regulatory risks, due to high levels of state intervention in the sector, and the need for long term certainty on pricing and demand.[23] In fact, approximately 10 percent of the investor-state disputes registered until February 2022 involved the renewable energy (power generation) sector.[24] This sector, in particular, could benefit from the involvement of retention mechanisms, especially mechanisms with a focus on preventing disputes. Another area for future consideration is the interaction between

[20] Success here refers to successful resolution of investor issues or grievances.

[21] Korean Ministry of Justice Press Release, Set-up of a Cooperative System to Prevent Investor-State Disputes with Foreign-Invested Firms (May 2, 2021).

[22] World Bank, *supra* note 9.

[23] World Bank and Energy Charter Secretariat, Enabling Foreign Direct Investment in Renewable Energy Sector: Reducing Regulatory Risks and Preventing Investor-State Conflicts (2023).

[24] *Id.*

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retention mechanisms and civil society and environment related agencies.[25] Further, the link between lead agencies for investment retention and dispute management can be further clarified as implementation experience grows.

Conclusion

Ultimately, understanding investment dispute prevention mechanisms not simply as a means of preventing ISDS cases, but also a means of retaining investors is crucial to understanding the role, scope, and design of such mechanisms. When states view such structures not only as dispute prevention mechanisms, but also *investment retention* mechanisms, they can better tailor such initiatives to proactively serve this important additional function.

[25] Rwanda, for example, is already considering a special process to fast-track resolution of investor issues in "sustainable" sectors, through more effective coordination with environment related agencies.

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