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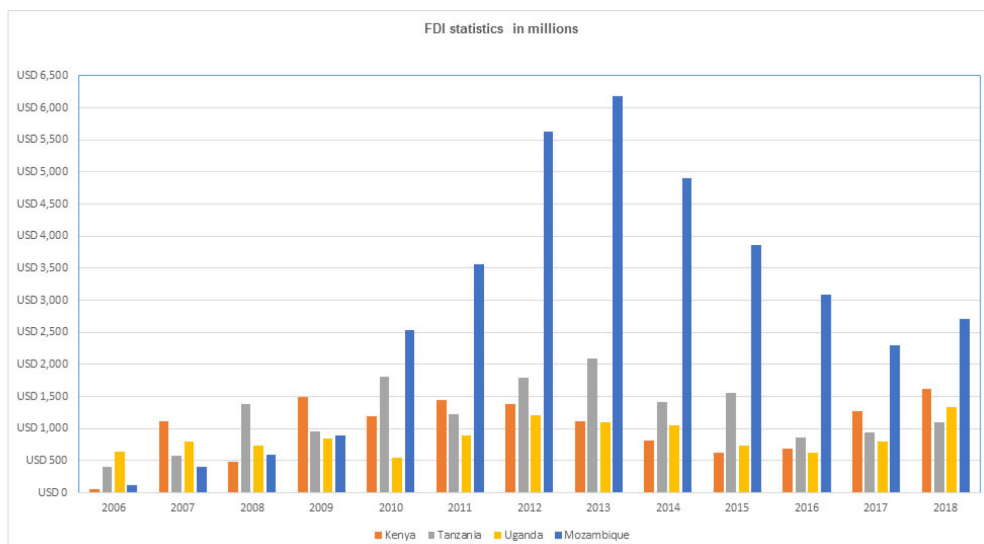
Foreign Direct Investment

Investor- State Relations

An Overview of Foreign Investment Protection in Uganda

1. Introduction

Many developing countries viewed foreign investment especially in the natural resources sector as an intrusion on state sovereignty until the late 1980's when perceptions began to shift. Preceding periods were largely characterised by protectionist policies that were aimed at limiting the inflow of foreign direct investment ("FDI"). Following the end of the cold war era that saw the triumph of capitalism over socialism in the late 1980's, many developing countries embarked on structural economic reforms focussed on creating a favourable environment to attract FDI. Uganda, Kenya, Tanzania and Mozambique are counting on FDI to facilitate the commercialisation of their hydrocarbon discoveries projected to cost several United States dollars ("USD") billions .These countries are also keen to continue attracting FDI to the other sectors to keep their economies diversified. This publication provides a discussion of the legal, contractual and treaty based instruments that Uganda has deployed to assure the protection of foreign investment in positioning itself as a competitive destination for FDI.



Source https://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx last accessed 18th September 2019

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2. What is foreign investment?

Foreign investment involves the transfer of assets from one country to another and falls into two broad categories namely portfolio and direct investment. Portfolio investment involves the acquisition of securities and is passive given that it hardly involves any element of control or participation in the assets that form the subject of the investment. FDI, by contrast is active. It involves the acquisition of a lasting interest in an enterprise operating in an economic environment other than that of the investor who must have an influence in the management of the enterprise.

There has been an enduring debate whether foreign portfolio investment just like FDI should be subject to protection under international law. One view point is that there should be no difference in terms of the protection given by customary international law because there is no difference regarding the risks assumed under both. This position is generally disputed under customary international investment law where only FDI is subject to protection. Many treaties in the area of foreign investment developed by capital exporting states have however broadened the scope for the definition of foreign investment to ensure the protection of portfolio investment under international law as well.

3. Evolving policy stance

FDI in developing countries has a long and chequered history that oscillates with trends in policy stances. The 1950's and 1960's were characterised by import substitution strategies, natural resource development leading the way in the 1970's, structural alteration and evolution of market economies in the 1980's and the increased role of the private sector in the 1990's.

FDI is not an entirely new phenomenon though it became more pronounced beginning with the eighteenth century. Early FDI can be traced to the medieval era where Mediterranean traders like the Genoese and the Venetians established banking operations in distant locations as early as 1200 CE to finance the trade which their ships carried out. From the eighteenth century, FDI followed colonial expansion within the context of colonial legal systems aligned to imperial power systems to assure protection for the investments that went into colonies. United Kingdom firms were overtaken by United States companies as the main source of FDI after the end of the Second World War.

The ending of colonialism in developing countries radiated sentiments of nationalism. The 1950's and 60's thus witnessed inward oriented strategies by developing countries because policy makers were concerned that unchecked FDI could potentially create economic dependence, weaken domestic enterprises as well as heighten political interference. Such policies generally discouraged FDI though it continued unabated to natural resource rich countries.

The early years of 1970's were characterised by escalating natural resource prices which had a twofold impact on FDI. Firstly, FDI increased in extractive sectors particularly petroleum on the backdrop of increased prices. Secondly, the balance of payments surplus for resource rich countries provided an abundant source of capital the result of which was developing countries becoming more reliant on sovereign borrowing and less interested in FDI. Tougher restrictions on FDI were introduced including expropriation of foreign investments resulting in further reduction of FDI in the later years of 1970's continuing into the first half of the 1980's.

The period after the second half of the 1980's witnessed gradual reduction in state ownership of companies. The rise of free market economics associated with President Ronald Reagan of the US and Prime Minister Margaret Thatcher of the UK in the 1980s and its spirited championship by the International Monetary Fund and the World Bank led to pressures being exerted on developing countries to liberalise their regimes on foreign investment and many have followed suit. Several reforms that include liberalisation of the economic environment supplemented by fiscal incentives and the privatisation of state parastatals have been pursued to attract FDI which is now prized by these countries for the bundle of assets that Multinational Enterprises install with their investments.

In their current pursuit of free market economy policies, many developing countries have undertaken reforms to ease doing business in their respective jurisdictions. They have reinforced investment protection assuring foreign investors that their investments may not be unjustifiably expropriated without fair and prompt compensation and ensuring fiscal certainty so as to be able to recoup investment as projected. The discussion below sets out Uganda's regulatory framework for the protection of foreign investment.

4. Legislative protection

A number of guarantees assuring the protection of foreign investment in Uganda are found in specific laws. The basic criticism of legislative based protection however is that Parliament can undo whatever it enacts.

Exchange controls that previously restricted the repatriation of funds out of Uganda were repealed in 1991, the same year that the Investment Code Act was enacted aimed at improving the general environment for doing business in Uganda. The investment Code Act augmented the protection of foreign investments through the preclusion of compulsory acquisition of private property except in national interest and subject to fair and prompt compensation as provided for by the Constitution. The Investment Code Act further provided for the window of international arbitration in accordance with the rules of procedure for arbitration of the International Centre for the Settlement of Investment Disputes ("ICSID") or within the framework of any bilateral or multilateral agreement on investment protection to which the Government and the country of which the investor is a national are parties to in the event of a dispute that cannot be resolved amicably.

The Investment Code Act was recently revised to align it to current business realities and circumstances. The updated Investment Code Act 2019 aims to revise and modernise the previous law but also makes the Uganda Investment Authority a one stop Centre for the coordination, promotion, facilitation, monitoring and evaluation of investment and investors, among others in Uganda. The Investment Code Act 2019 also introduces preferential treatment of domestic investors and citizens of East Africa Community Partner States which was not the case with the previous legislation.

5. Treaty based protection

Uganda has entered into a number of Bilateral Investment Treaties ("BITs") which provide for an additional layer of protection for foreign investments. BITs concluded between capital exporting and importing countries set out substantive principles for investment protection as well as the procedures for investor state arbitration. Investors domiciled in countries who are party to BITs are able to bring claims against their host countries for contravention of investment terms. Umbrella, Fair and Equitable and Most Favoured Nation clauses embedded in BITs ensure the provision of additional protection for foreign investment.

Since 1966, Uganda has entered into 17 BITs but 6 are currently in force. The BIT with Germany came into force in 1968, Switzerland in 1972, United Kingdom in 1998, Netherlands in 2003, France in 2004 and Denmark in 2005. Other BITs entered into but not yet in force include Egypt in 1995, South Africa in 2000, Eritrea in 2001, Cuba in 2002, Nigeria in 2003, Zimbabwe in 2003, China in 2004, Luxembourg in 2015 and United Arab Emirates in 2017. The earlier BIT entered into with Netherlands in 1970 was terminated so is the one with Italy entered into 1998.

ICSID in Washington DC has already handled at least two claims brought under BITs involving the government of Uganda and International Oil Companies though both were withdrawn prior to the arbitral award and involved tax disputes. These were Total E&P Uganda BV vs. Republic of Uganda ICSID Case No. ARB/15/11 and Tullow Uganda Operations PTY LTD vs. Republic of Uganda ICSID Case No. ARB/12/34.

a) Umbrella Clause

Umbrella clauses in BITs oblige host states to observe specific undertakings towards foreign investors. Umbrella clauses are usually broadly written to cover every conceivable obligation of the host state and can elevate contractual claims to the level of a treaty claim. Investors often rely on umbrella clauses to pursue claims when a host state's actions do not otherwise breach the BIT.

b) Fair and Equitable Treatment ("FET")

The obligation to accord fair and equitable treatment to foreign investments is embedded in many international investment agreements. International tribunals consider FET clauses to broadly require host states to act consistently, transparently, reasonably, without ambiguity and discrimination to ensure due process in decision-making and respect investors' legitimate expectations.

c) Most Favoured Nation

A most-favored-nation (MFN) clause requires a country to provide an investor from a treaty country with treatment that is no less favourable to that investors from third countries enjoy.

6. Contractual based protection

Foreign investors are keen to include stabilisation clauses in their investment agreements. These clauses ensure that future changes in a country's legislation do not erode the commercial value of projects considered under the investment agreements concluded. Stabilisation clauses have trans mutated over time and to date there are four types used in international investment contracts namely freezing, prohibition on unilateral change, balancing and allocation of burden as discussed in detail further below.

Type of stabilization clause	Discussion
Prohibition on unilateral changes	They are also known as intangibility clauses. They ensure that the terms of the investment agreement are neither modified nor abrogated except with the contracting party's mutual consent.
Freezing clauses	The host state is precluded from changing its legislation in relation to the relevant project. Such clauses are criticized as encroaching on a country's sovereign legislative prerogative.
Allocation of burden	These clauses seek to allocate the fiscal and related burdens created by a unilateral change in the law usually to the State.
Balancing clauses	These are sometimes called economic stabilization clauses. They provide for automatic adjustments or negotiations to restate the initial economic balance of the investment should there be an amendment to legislation with a fiscal impact to the investment.

7. Conclusion

Investment protection influences more the attraction of FDI if its complemented by other economic measures. Governments in developing countries need to ease doing business by reducing on red tape, eliminating rent seeking tendencies amongst government officials, investing in infrastructure and skills development, facilitating domestic access to capital as well the provision of a suite of fiscal incentives.

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At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

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From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

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Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

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