Overview of Political and Regulatory Risks in International Energy Investment
by E. Mohajeri

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Political and Regulatory Risks

Overview of Political and Regulatory Risks in International Energy Investment

By Ensieh Mohajeri

Introduction

The demand for energy is growing rapidly. Projected demand for energy products has increased investment in the energy sector, particularly in emerging economies. Every energy investment, especially in developing states, is fraught with risks particularly political and regulatory risks. The high degree of susceptibility of international energy investment to political and socio-economic conditions within the host states, and decisions made by the host government, arises from the specific characteristic of these projects and the energy industry.

Hence, eliminating or reducing political and regulatory risks has been one of the major concerns of both energy investors and host countries. The more stable the social, political, and legal structure of a country, the more likely the country will attract foreign investment. Although, the very nature of these risks makes it impossible to remove or eliminate the risks, there are several accepted and effective strategies to mitigate and minimize political and regulatory risks.

However, the first step in developing a coherent strategy to manage these potential threats to energy investment is to understand the nature and different types of political and regulatory risks, which I will discuss in this paper.

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2 ‘[According to] the Organization of the Petroleum Exporting Countries (OPEC), oil demand will continue to grow strongly and oil will remain the world’s single most important source of energy for the foreseeable future. Based on this report, although, the share of oil as an energy source will fall slightly from over 40% today to 39.2% in 2020, still will be the world’s single largest source of energy. This reduction in oil market share is due to the growth in demand of natural gas.’ (Mustafa Erkan, International Energy Investment Law: Stability through Contractual Clause, 4 (2011)).


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**Nature of the Political and Regulatory Risks**

In general, risk is the ‘uncertainty of the result or happening; or the chance of damage or loss in the future.’ As related to the commercial activities, risk refers to ‘the possibility that future conditions will be less favorable than forecasted or that future events will yield less profit than expected.’ Typically, investors face a variety of risks generally subcategorized as natural, commercial, and political and regulatory risks. International energy investment is affected by all of these risks but is peculiarly subject to political and regulatory risks because of the particular nature of the energy projects.

First, energy investments may be halted or otherwise hindered by the intervention of unpredictable natural disasters such as earthquakes, floods, and storms, which contracting parties cannot reasonably be expected to overcome. Natural risks are typically subject to the *force majeure clause* of an investment contract and addressed the responsibility of each party if any of these events occurred. Moreover, insurance policies may cover some of these risks and at least partially compensate investors in the event of their occurrence.

Second risk that investors in energy sector are typically faced with is commercial risks. Commercial risks refer to ‘any unanticipated factor that raises the previously estimated costs of a project or lowers its expected profits.’ Among these factors are changes in supply and demand of goods and services, increases in the price of raw materials, currency fluctuation, and changes in market price, which may adversely affect the profitability of the investment project or fundamentally change the economic equilibrium of the contract. Commercial risks are measurable, usually assessed by the financial institutions prior to lending or guaranteeing the investment capital, and are seldom covered by commercial insurance. Also, contractual mechanisms, such as the *price revision clause*, *indexation clause*, or a more expansive *adaptation clause*, may be used to overcome the price risk, cost risk, and even profit risk.

The third and especially volatile risk to energy investments are political and regulatory risks which defined by Luis T. Wells, Jr. as:

Threats to the profitability of a project that derive from some sort of governmental action or inaction rather than from changes in economic conditions in the marketplace. In each case, action or inaction by political officials can have a significant impact on the success of an energy project.

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8 Ibid.
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authorities or their agents, rather than changes in supply and demand of goods and services, must be the proximate cause of the change in profitability.\(^\text{10}\)

Therefore, the distinguishing element of political and regulatory risks is the origin. These risks are caused by intervention of the host government (or sometimes by its nationals or by a third country) with an investment project that fundamentally alters the prospects of profitability of the investment or deters the smooth performance of the projects.

Host states may interfere with investment projects for several reasons, including:

- Nationalistic concern over the domination of the economy by foreign elements\(^\text{11}\)
- Hostile attitude toward foreign investment\(^\text{12}\)
- Global changes in investment models to the disadvantage of foreign investors\(^\text{13}\)
- Willingness of the incoming government to change foreign contracts made by the previous governments\(^\text{14}\)
- Fundamental change of circumstances which makes compliance by the host government too onerous to comply with the contract\(^\text{15}\)
- Economic and environmental concerns of the host state, which cause the host government to exercise its regulatory power to protect the country’s best interests\(^\text{16}\)
- Deterioration in general law and order in the host state, which makes the foreign investment a target for attack by groups of dissidents\(^\text{17}\)

Depending upon the situation, each or a combination of the above circumstances may lead the host government to interfere with foreign investments in energy industry. This interference can take place in any one or more of the following ways: \(^\text{18}\)

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\(^{10}\) Theodore H. Moran, *Political and Regulatory Risks in Infrastructure Investment in Developing Countries: introduction and overview*, 5 CEPMLP Internet Journal, available at: http://www.dundee.ac.uk/cepmlp/journal/html/vol5/article5-6a.html. To read other international institutions and scholars’ definition of political and regulatory risks, see Mustafa Erkan, (n 2), at 22-23.


\(^{12}\) For example, in early 2003, about 100 oil workers of different nationalities were held hostage by striking Nigerian workers aboard offshore installation owned by Transocean Inc. (Firoozmand, MahmoudReza, (n 7))

\(^{13}\) Beginning in the 1960s, developing states replaced the traditional petroleum concession with modern concessions or with production sharing contracts, both of which gave the host government more control over the investor’s operations. (M. Sornarajah, *The International Law on Foreign Investment* 81-83 (2nd ed. 2004))

\(^{14}\) See examples at: *Ibid*, at 83-85

\(^{15}\) The facts of Settebello v. Banco Totta A Cores are illustrative. In this case, ‘a state-owned shipyard in Portugal had made a contract to build a large oil tanker with penalty provisions in the contract for late performance. The shipyard was unable to meet the time limit set in the contract and was in danger of having to pay a large penalty. The Portuguese government intervened through legislation and altered the penalty provisions in the contract. The counterparty was unable to secure relief from this change in law either within or outside Portugal.’ (*Ibid*, at 85)

\(^{16}\) *Ibid*, at 85-86.

\(^{17}\) *Ibid*, at 87.

\(^{18}\) Noah Rubins & N. Stephan Kinsella, (n 6), at 4.
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- Expropriation of the investors’ assets or contract rights
- Refusal to allow the investor to remove equipment from the host state
- Imposition of discriminatory taxes and tariffs on the investment
- Legislations compelling transfer of technology or violating investor’s or related contractor’s intellectual property rights
- Repudiation or forced renegotiation of the investment contract
- Non-payment of debt owed to the investor
- Imposition of unexpected controls on the conversion or export of local currency
- Improper calling of performance bond or letter of credit by the host government, and
- Loss of assets or contract rights due to war, insurrection, terrorism, or other unrest.

Political and regulatory risks have been categorized in different manners by authors and international institutions. But before moving on to the discussion about the variety of political and regulatory risks, I will briefly review the reasons why international energy investments are particularly sensitive to the political and socio-economic circumstances of the host countries.

Why Are Energy Investments Prone to Political Risks?

There are several reasons why international energy investments are vulnerable to political and regulatory risks:

A. Geopolitics of the energy industry

The geopolitics of the energy business could be the main cause of various political risks. The distribution of proved oil reserves in the world shows that just a small number of states in the Middle East share over half of the top 10 countries, in terms of oil reserves. Five of them are Arab states and three others are Iran, Nigeria, and Venezuela, which have experienced and continue to experience various political upheavals, including wars, embargoes, revolutions, and civil unrest.

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19 For example, Professor Theodore H. Moran divided political risks into three categories: traditional political risks, regulatory risks, and parastatal performance risks. (Theodore H. Moran, (n 10)). (Also for more suggested categories see: Mustafa Erkan, (n 2), at 25-26)

20 See the classifications in Energy Charter Treaty (ECT) and two of the major insurance companies offering coverage for political risks: Overseas Private Investment Corporation (OPIC) and Multilateral Investment Guarantee Agency (MIGA).


22 ‘Until the early 1990s, four out of six major international oil shocks were caused by wars in which the major oil producing countries, particularly Arab states, had been directly or indirectly involved. The remaining two wars resulted from transitions of political power in Iran. This list should also include the crises following the 11 September 2001 bombing of the World Trade Center in New York City, resulting in wars in Afghanistan and in Iraq.’ (Firoozmand, MahmoudReza, (n 7)). More recently, ongoing political challenges in Tunisia, Egypt, Libya, Bahrain, Yemen and the increasing sanctions against Iran should also be added to this list. As I discuss later in this paper you will see all of these challenges and situations raise the risks for the investors.
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Russia is also among the top ten countries in terms of oil reserves. While Russia is not as unstable as those just mentioned, political risk is nevertheless high in Russia. Then, only Canada (ranked third) could be said to be a low political-risk state. Of the next seven, only the United States (ranked fourteenth) would be considered a low political-risk state. The rest, Kazakhstan, Qatar, China, Angola, Algeria, and Brazil, would all be considered to have at least moderately high political risk.  

Therefore, the vast share of the world’s oil reserves lies in comparatively developing or unstable countries, which have greater political and regulatory risks than developed countries.

B. The Extensive Participation of the Government in the Projects

Most of the major producers of petroleum are countries highly dependent on petroleum revenues such as the OPEC countries. In other words, capture of petroleum economic rents is vital to the survival of these nations. Therefore, in these countries, governments play a prominent role in regulating all aspects of the petroleum industry, including entry, operations, expatriation, trade, sale, pricing, quality of services and products, and other aspects of investors’ behavior.

Further, in almost all of these countries, energy and natural resources are controlled by state-owned companies that participate with foreign investors in all profitable petroleum investments. The significant participation of state-owned enterprises in the energy industry greatly increases the possibility of state interference with an energy project, allowing the host state to interfere with the contract as both a sovereign power and a contractor.

C. Long Duration of the Energy Investment Contracts

International energy projects require major long-term investments. Their long duration makes these projects sensitive to all political, social, and economic changes that may occur in the life span of the investment contract. During the long duration of such projects both the internal circumstances of the host country, including its political system and legal structure, and the external circumstances, including access to technology and markets and relevant geopolitics, may change. All of these changes may fundamentally alter the investment circumstances.

D. Intensive Capital Investment and Its Long Payback Period

Finally, investment in energy projects is typically large and any cost recovery and profits require a lengthy period, perhaps long after the bulk of the capital investment has already occurred. Such investments are typically ‘quasi-irreversible: the owners cannot simply pack up and leave, or, during negotiations with the host officials, convincingly threaten to pack up and

24 Mustafa Erkan, (n 2), at 27.
25 Theodore H. Moran, (n 10).
leaves. Consequently, after the investment has been made, the host government’s behavior towards the investors may become opportunistic. Bargaining power shifts dramatically in favor of the host state, and the investors are not well positioned to defend their own interests.

Overall, according to the reasons mentioned above, energy projects encounter variable risks following changes in political, social and economic circumstances of the host state. Energy investment projects are peculiarly open to public criticism, examination, and intervention. Therefore, successful operation and smooth performance of these projects are tied to the decisions made by the given host government, as well as political and socio-economic conditions within the host states. Now, let’s move on to discuss different types of political and regulatory risks.

Different Types of political and Regulatory Risks

In general, political and regulatory risks fall into one or more of the following categories:

A. Expropriation, Nationalization and Confiscation

For decades the major political risks to foreign investment were expropriation, nationalization, and confiscation, situations in which a host country takes an investor’s assets into the state’s ownership. Since these political risks were very common in the 1960-70s, one scholar categorized them as the traditional leading political risks. However, still there is possibility that these risks arise subsequent to fundamental changes in the political structure of the host country.

Expropriation generally refers to the ‘governmental taking or modification of an individual’s property rights.’ As Professor Brownlie explained, ‘expropriation is the deprivation of a property right by state organs or a permanent transfer of management power and control.’ Traditionally, the state accomplishes the “taking” by acting under local law to annul the foreign investor’s property rights or perhaps by using force against the foreign investor.

In international law, expropriation is divided into lawful and unlawful expropriation. Legal expropriation must meet three requirements: 1) the expropriating measure must serve a public purpose, 2) the measure must not be arbitrary or discriminatory, and 3) it must be

26 Ibid.
27 This classification is just for better understanding of the nature of political and regulatory risks. In practical terms, differentiating among the different types is not easy as overlap is likely.
28 Theodore H. Moran, (n 10).
29 Bryan A. Garner, (n 5), at 662.
30 Ian Brownlie, Principles of Public International Law , 531-532 (4th ed. 1990)
31 Noah Rubins & N. Stephan Kinsella, (n 6), at 6.
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accompanied by prompt, adequate, and effective compensation. An expropriation in the absence of these conditions is classified as unlawful.

The risk of expropriation is typically great in times of political instability such as prevailed following the systematic changes in Cuba in 1959 and in Iran in 1979. Also, because expropriation involves the annulment of property rights, it is more likely to occur in states that do not recognize private property ownership, such as in communist states. Therefore, examining the legal, social, and political background, as well as the history of the prospective host country, will allow an investor to assess the likelihood of an expropriation by that country.

Nationalization is ‘the act of bringing an industry under governmental control or ownership.’ The main difference between nationalization and expropriation is that, in nationalization, the government takes all properties of a particular nature and does not just target a single economic activity or foreign investment. In addition, in nationalization, a state takes the investor’s property as part of general program of social and economic reform through enacting new rules which prioritize public ownership over private ownership.

Finally, the term ‘confiscation’ refers to ‘the State seizure of property without compensation, usually to punish the owner for who he is or for what he has done.’ Thus, even in the absence of specific features, such as non-discrimination, fair and equitable treatment, the lack of public interest and paying compensation, confiscation is considered legal in international law.

In summary, expropriation refers to the taking of one or several properties within a single area of economic activity, whereas nationalization refers to the government’s taking of all properties within a business sector. Both nationalization and expropriation require compensation, although the amount and value may vary. In contrast, confiscation does not provide compensation and there may be discrimination and no public purpose to justify the taking.

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32 Adequate compensation is generally understood to be equivalent to the market value of the expropriated investment; prompt compensation means without delay; and effective compensation means that the payment has to be made in a convertible currency. (Rudolf Dolzer & Christoph Schreuer, Principles of International Investment Law 92-93 (2008)).

33 This classification may have critical importance. For example, some insurance policies require that an expropriation be “illegal” under international law to be covered by the policy. Moreover, regarding the remedy available, the investor can secure only appropriate compensation in the case of a legal expropriation. In contrast, for unlawful expropriation, the primary remedy may be restitution in kind and, if that is not possible or practicable, the remedy is just compensation. (11 Tuomas Kuokkanen, International Law and the Expropriation of Natural Resources, Finnish Yearbook of International Law, 326 (2000))

34 Noah Rubins, N. Stephan Kinsella, (n 6), at 9.
35 Bryan A. Garner, (n 5), at 1123.
36 Mustafa Erkan, (n 2), at 63.
37 Ian Brownlie, (n 30).
38 Noah Rubins & N. Stephan Kinsella, (n 6), at 10.
39 As Professor Brownlie explains ‘[I]f compensation is not provided, or the taking is regarded as unlawful, then the taking is sometimes described as confiscation.’ (Ian Brownlie, (n 30)).
Currently, expropriation, nationalization, and confiscation are no longer considered to be political risks that are likely to arise in most states. The most important reason that these political risks are lower is that most states have realized that an open taking of property by the host state will greatly dampen the investment climate in that state. Expropriation, though perhaps politically popular before, attracts long-term negative publicity from the investment community and is likely to result in lasting damage to the state’s reputation as a place for foreign investment. Today, an indirect form of expropriation, usually accomplished by regulatory interference or through new and excessive taxation, is more likely.

**B. Indirect or Creeping Expropriation**

One of the most prominent political risks to foreign investment in the 21st Century is creeping or indirect expropriation. In *Middle Eastern Shipping and Handling Co. v. Egypt*, indirect expropriation was described as ‘measures taken by a state the effect of which is to deprive the investor of the use and benefit of his investment even though he may retain nominal ownership of the respective rights.’

The key feature of creeping expropriation is that the host government does not directly take the investor’s property, but, through using general instrument of property or commercial law, denies economically viable use of the property by the investor, thus undermining the property’s value and functionality. For example, host government may impose new measures on the price and quality of goods and services, new tax and tariffs on products used or produced by the investment projects, or enforce new environmental and safety standards in a manner that materially and negatively affects the performance or profitability of the investment.

Whether regulatory measures are unlawful and thus tantamount to an expropriation is largely a function of the depth of the harm done to the foreign investor. Generally, a state does not commit unlawful creeping expropriation if it enacts a generally-applicable regulation or tax for a ‘legitimate’ government purpose. In *Agins v. Tiburon* the court held that ‘a regulation does not amount to expropriation if it substantially advances legitimate state interests and does not deny an owner all economically viable use of his property.’

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40 Rudolf Dolzer & Christoph Schreuer, (n 32), at 92. For more explanation see: Alfred J. Boulos, (n 11), part II.
43 Theodore H. Moran, (n 10).
44 Noah Rubins, N. Stephan Kinsella, (n 6), at 13.
C. **Currency Inconvertibility or Non-Transferability**

Energy investments are also susceptible to any fundamental changes in a host country’s monetary system. Investment decisions are based on the expected revenue of the project, which is affected by the interaction between local and foreign currency. Also, new regulatory measures may affect the foreign investor’s ability to exchange local income for the hard currency required to pay his debts or to expatriate profits outside the host state.

Currency inconvertibility is the risk that investors will not be able to exchange local currency revenues for hard currency that may be required for meeting debt obligations as well as the risk that local currency will be converted at a discriminatory or artificially low exchange rates. Non-transferability risk is the risk that the central bank of the host country will prohibit the transfer of local or foreign currency outside of the country.\(^{46}\)

Currency crises and the imposition of currency restrictions often occur in developing economies after intense short-term economic expansion. Therefore, foreign investors should pay particular attention to fiscal practices before investing in a booming economy. Further, investors should carefully examine the history of government fiscal policies, particularly the government’s responses to fiscal crisis.\(^{47}\)

D. **Political Violence**

Political violence and civil unrest can greatly harm energy investments. This group of political risks includes a wide spectrum of events, including war, revolution, insurrection, civil strife, terrorism, kidnapping, and sabotage.\(^{48}\) Lack of public security in the host country not only may interrupt or terminate profitable investment operations, but will also endanger the lives of foreign managers and laborers and adversely affect the performance of the project or even the project may be directly targeted.

Unlike other kinds of political risks, political violence may not be within the control of the host state and even may be caused by the intervention of other countries. Therefore, under customary international law, the host government is not responsible to compensate the investor for damages caused by non-governmental actors, such as rioters, rebels, or looters, unless the host government has assumed the risk by guaranteeing security.\(^{49}\) Therefore, in the absence of local law, contract, or treaty that provides otherwise, the host government does not have to compensate the foreign investor for the occurrence of such a risk.

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46 Theodore H. Moran, (n 10). ‘The risk of currency devaluation is usually classified as a commercial rather than political risk even where inflation and devaluation are the direct result of government action.’ (Noah Rubins & N. Stephan Kinsella, (n 6), at 18).
47 Noah Rubins & N. Stephan Kinsella, (n 6), at 19.
48 Firoozmand, MahmoudReza, (n 7).
E. Breach of State Contracts

As mentioned before, the government almost always plays a significant role in energy projects, either directly or through a state-owned enterprise, such as a national oil company. Also, it is very likely that some service contractors retained by the investor may be owned or controlled by the host government. Therefore, the government may take steps in favor of its own companies, and enact new laws regulating such contracts or nullifying their effectiveness. Since the company owned or controlled by the state will likely have the government’s support, including judicial support, the foreign investor will have little leverage to force the state party to meet its contractual commitments. 50

Perhaps the best way to cope with this hardship is to include an arbitration clause in the contract. 51 In addition to an arbitration clause, other contractual provisions, such as a choice of law clause or a waiver of sovereign immunity clause may give foreign investor required protection. 52

F. Corruption

Corruption is common in developing states with inefficient legal and regulatory systems. 53 In states with weak legal and regulatory systems, signing, performing, or resolving a contract, or issuing a required licenses or permits may require the bribery of government officials. Bribes not only have considerable impact on establishing and performing of the contracts, they are also a significant barrier to economic development of and true competition in host countries. 54

In addition, the risks associated with bribery are multiplied for investors from certain countries that have implemented strict extra-territorial anti-corruption laws. 55 Moreover, following political changes in the host country, the new government may terminate the investment agreement or interfere with operations if the project is believed to have been tainted by corruption in the previous government. 56

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50 Theodore H. Moran, (n 10).
52 For more information about “Waiver of Sovereign Immunity Clause” see: Ibid, at 63-65.
54 Estimates show that in some developing countries various forms of corruption siphon away 5 to 30 percent of all public funds. (Mehmet Ogutau, (n 3))
55 Lucinda A. Low, (n 53)
56 The case of Enron’s Dabhol Project in India, which concluded in 1992, is a very good example of this. After state elections in March 1995, a new government, which had been critical of this project throughout the election campaign, unilaterally canceled the project, citing excessive costs and potential corruption as the main reasons. Although, ultimately Enron renegotiated the project with the new government, they estimate costs of 16-month
The best deterrent to corruption is self-policing. At every stage of an investment, including establishing, operating, expanding, and renegotiating an investment, the investor must be mindful of the reputation of the host government for corruption, comply with applicable anti-corruption laws, treaties, or conventions, monitor all employees and agents to guard against corruption, and maintain a robust recordkeeping system to guard against improper payments.

G. Trade Restrictions

Trade restrictions potentially threaten foreign investment when performance of a project depends upon imported components or where the revenue of the investment depends upon exporting the final products. The ultimate result of trade restrictions might be very similar to expropriation or regulatory risk, yet in some cases, the tribunal may not view the situation as such. However, in some cases, tribunals have held that the government has to compensate the investor when the trade restrictions were unequal, discriminatory, unfair, and without lawful purpose.

Unlike other political risks, trade restrictions may result from political, social and regulatory changes by third countries, such as the importing or exporting country, or an intermediary country used to effectuate the transaction or to transport the goods and services during the course of exportation or importation. In order to have a good estimation of potential trade restrictions, an investor must simultaneously take into account trade conditions in all related states, as well as the host state.

H. Sanctions

Finally, economic sanctions, sometime with a significant extraterritorial effect, have sprung up, often unpredictably. Sanctions make it difficult to maintain an investment project and its contractual architecture. Sanctions occur when a state-enacted prohibition denies the targeted state access to foreign markets for export (boycott) or import (embargo) or denies the state access to financial markets, investment transactions, and other forms of commerce.

Sanctions typically are imposed to force the targeted country to change its political, social, economic, or foreign policies. Sanctions may arise from political conflicts between sanctioning states and the targeted state, in which case the sanctioning state seeks substantial delay at USD 175 million. (Sedar Frank, Attracting Foreign Direct Investment into Infrastructure: Why is it so Difficult? 42-43 (2000))

See, e.g., OECD Convention on Combating Bribery of 1997. For discussion, see Mehmet Ogutau, (n 3)

For example, see S.D Myers Corp Vs. Canada, Partial Award of Nov. 13, 2000, 40 ILM 1408 (2001), cited by Noah Rubins & N. Stephan Kinsella, (n 6), at 23.


changes in the targeted country’s behavior or seeks an outright change in government, thus using sanction as an alternative to war to achieve the desired outcome.\(^{61}\)

Among different types of sanctions, economic sanctions, such as imposing restrictions on the import or export of goods and services, may have significant impact on energy investments. Sanctions may also be imposed on banks and financial institutions to deny the targeted state access to revenues.

Economic sanctions may be imposed just by one country against another, or may be enforced by several countries, or even sponsored by the United Nations. The larger the economic power of the sanctioning country or countries, the more crippling and effective harsh sanctions are likely to be on the targeted country, especially if that country is economically weak or highly dependent upon foreign trade. Larger and more economically diversified countries, countries that have time to adjust their economic system to sanctions, and countries with a very effective repressive regime tend to be less sensitive to sanctions. Sanctions based on serious political will and energetically enforced are more effective than sanctions that are reluctantly adopted by the government as a response to domestic pressures.\(^{62}\) Sanctions are relatively new risks for investors, and little protection is available to avoid or mitigate them.\(^{63}\)

**Conclusions and Recommendations**

Measuring political and regulatory risks prior to investing in a state and monitoring these risks throughout the course of investment operations are key means to a successful investment experience, particularly for energy investors.

In order to have a complete analysis of political risks associated with the investment and to mitigate these risks and their possible effects on the investment, foreign investors must carefully examine and follow the political and socio-economic changes in the host country. The investor must evaluate the relationship of the host country with other countries, the host country’s ability to control political, social, and economic crisis, and the host country’s legal and regulatory structure and its stability.

The more well developed a state’s legal and regulatory framework, including investment laws, property laws, protection of intellectual property rights, tax laws, environmental regulations, competition policies, and monetary measures, the less likely the state is to have high political and regulatory risk.

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\(^{61}\) The most recent economic sanctions imposed by the UN Security Council against Iran and new debates around imposing more financial and economic sanctions against Iran are good examples of the use of sanctions as a last resort before engaging in an act of war.


\(^{63}\) Thomas Waelde, (n 42).
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In addition, investors may use accepted and effective strategies for mitigating and managing political and regulatory risks in the investment. These strategies fall into three general groups:

Firstly, using contractual methods, including appropriate contractual structure and contract provisions to minimize, manage, and possibly transfer these risks, can be very effective management and mitigation tools.  

Secondly, taking advantage of international investment treaties between the host state and the country of the foreign investor; the host government, in the course of its relationship with other countries, may enter into these treaties to promote foreign investment to attract needed capital to develop its country. These treaties typically include two types of provisions: provisions to protect foreign investment against political and regulatory risks, and provision for dispute resolution.

Finally, foreign investors may benefit from services offered by financial and insurance institutions that allow the partial transfer of political and regulatory risks to third party insurers. However, this method is expensive and just a few institutions offer insurance coverage for direct investment in major projects. Other than the Multilateral Investment Guarantee Agency (MIGA) insurance which is available to almost all investors, other insurances are regional institutions available only to certain projects or investors.

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64 For discussion about contractual methods, see: Noah Rubins, N. Stephan Kinsella, (n 6), at 31-68.
66 The protection provisions addressing fair and equitable treatment, full protection and security, national treatment, most-favored nation treatment and provisions on compensation for losses incurred by foreign investors as a result of expropriation or other compensable loss; and dispute resolution provision giving investors the right to submit a dispute to an international arbitral tribunal. (John W. Boscaroil, Foreign Investment Protection Treaties: Opportunities in the Petroleum Industry, 44 Alberta L. Rev. 115 (July, 2006))
68 Over 97% of the world’s countries are the members of MIGA. (Gerald T. West & Ethel I. Tarazona, ‘MIGA and Foreign Direct Investment’, 1998; and ‘Official Commentary on Convention Establishing the Multilateral Investment Guarantee Agency’, available at: http://www.miga.org)
69 For example: Overseas Private Investment Corporation (OIPC) in the United States, the Inter-Arab Investment Guarantee Corporation among Arab countries, the Compagnie Francaise D’assurance Pour Le Commerce Exterieur (COFACE) in France, the Nippon Export and Investment Insurance (NEXI) in Japan, and Insurance Institution of Deutsche Revision in Germany.