Paul E. Comeaux and N. Stephan Kinsella, "Political Risk," Chapter I.1 in *Transnational Contracts*, Vol. 1, edited and compiled by Charles Stewart (Dobbs Ferry, New York: Oceana Publications, Inc., 1997)

Chapter 1 Political Risk

1.01 In this chapter, we discuss the general nature of political risk: the various types or manifestations of political risk, factors that contribute to political risk, and ways that investors can assess the political risks inherent in particular investment regimes or with respect to certain investments.

A. Risk and Investment

1.02 "Risk" is a concept explored at length in the economic, political science, and legal literature.[1] Here we will not delve into theoretical detail about the nature of risk, but a brief discussion of the relationship between risk and investment is in order. As a general matter, human action is aimed at achieving a goal or result at some time in the future. Because the future is uncertain, every human action involves a "risky speculation."[2] If the future is as predicted by the actor, the action is successful and he earns a "psychic profit." But if the future does not unfold as expected, the result sought may not be achieved. In this case, the actor does not achieve his goal; he suffers a loss.

1.03 Investment, including foreign direct investment (FDI), is one type of human action in which the profit sought is economic or monetary in nature. The investor seeks to earn a monetary profit at some future time—a future time at which the investor forecasts that revenues from products or services sold will exceed the previous costs of the investment plus interest.[3] For the investor, and for our purposes, risk should therefore be understood as the possibility that future conditions will be less favorable than forecast—that future events will yield less revenue than expected.

1.04 Obviously, investors face a variety of "risks" in this sense, in that any number of events may unfold that lead to economic loss. In hindsight there can be no risks, only history. The future is uncertain because neither natural events nor human action can be predicted with certainty.[4] Demand for a given product may not develop as the investor predicts; a competitor might undercut the business in which he has invested; or there may be an unanticipated natural disaster that affects consumer demand or costs. All investors must face such risks.

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1 For general background on the theory of risk and human behavior, *see* LUDWIG VON MISES , HUMAN ACTION (4th ed. 1996), esp. ch. VI, available at http://www.mises.org; FRANK H. KNIGHT , RISK, UNCERTAINTY AND PROFIT (1971 [1921]), esp. ch. 7, available at http://www.econlib.org ; RICHARD VON MISES , PROBABILITY, STATISTICS, AND TRUTH (1957), esp. chs. 1 and 3; also TIM BEDFORD & ROGER COOKE, PROBABILISTIC RISK ANALYSIS: FOUNDATIONS AND METHODS (2001); PETER BERNSTEIN , AGAINST THE GODS: THE REMARKABLE STORY OF RISK (1998).

2 MISES , HUMAN ACTION, *supra* note 1 at 106.

3 MISES , HUMAN ACTION, *supra* note 1 at 637.

4 *See also* Hans-Hermann Hoppe, *On Certainty and Uncertainty, Or: How Rational Can Our Expectations Be?*, 10:1 R. AUSTRIAN ECON. 49–78 (1997), available at http://www.mises.org .

1.05 But investors also face risks due to the actions of the State that controls the territory hosting the investment. States engage in a variety of actions that can cause loss for foreign investors. They can unexpectedly raise taxes, seize the investor's assets, outlaw the investment activity, or impose new and unexpected regulatory conditions. This type of risk is the result of the exercise of political power,[5] and is naturally referred to as *political* risk.[6]

1.06 Several prominent commentators agree that "political risk" implies "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."[7] Political risk is the probability that a host government will, by act or omission, reduce the investor's ability to realize an expected return on his investment. Most commonly, political risk manifests itself by the host State directly or indirectly *confiscating, interfering with, or destroying all or a portion of an investor's property rights*.[8]

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5 As Hoppe notes:

> One can acquire and increase wealth either through homesteading, production and contractual exchange, or by expropriating and exploiting homesteaders, producers, or contractual exchangers. There are no other ways. Both methods are natural to mankind. Alongside an interest in producing and contracting there has always been an interest in non-productive and non-contractual property and wealth acquisitions. And in the course of economic development, just as the former interest can lead to the formation of productive enterprises, firms and corporations, so can the latter lead to large-scale enterprises and bring about governments or states.

Hans-Hermann Hoppe, *Banking, Nation States and International Politics: A Sociological Reconstruction of the Present Economic Order* 4(1) R. AUSTRIAN ECON. 55, 60–61 (1990), available at http://www.mises.org.
See the German sociologist, Franz Oppenheimer's view on the two mutually exclusive ways of acquiring wealth; FRANZ OPPENHEIMER, THE STATE 24–27 (1926). *See also* ALBERT JAY NOCK, OUR ENEMY, THE STATE 3 (1973).

6 For a holistic approach towards political risk management, see *generally* THOMAS NEKTARIOS PAPANASTASIOU, THE LEGAL PROTECTION OF FOREIGN INVESTMENTS AGAINST POLITICAL RISK. JAPANESE BUSINESS IN THE ASIAN ENERGY SECTOR 33-37 (2015); (This book is an empirical study of law. It analyzes a multi-tier legal framework by using different types of assessment techniques and by exploring the role of different legal regimes, such as international investment treaties, political risk insurance and investor-State contracts).

7 Theodore H. Moran, *Political and Regulatory Risk in Infrastructure Investment in Developing Countries: Introduction and Overview*, 5(6) CEPMLP JOURNAL, at 3 (citing Harvard Professor Louis Wells, Jr.); Political risk is defined as "the host government's unwarranted interference with the foreign investment which should be political in nature and should adversely affect the investment's operation or damage its economic interests"; *See* PAPANASTASIOU, *supra* note 6, at 24.

8 In various contexts, including within the discourse of investment arbitration, political risk is sometimes referred to as "regulatory risk." *See, e.g.*, S. Linn Williams, *Political and Other Risk Insurance: OPIC, MIGA, Eximbank and Other Providers*, 5 PACE INT'L. L. REV. 59 (1993); *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States* , ICSID Case No. ARB(AF)/00/2, Award of May 29, 2003 at para. 117–123, 43 I.L.M. 133, 163–166 (2004). One type of political risk not often recognized as such is the innate ability of legislatures to enact new laws, to change the "rules of the game" from day to day. As Italian legal theorist Bruno Leoni pointed out, even if a given statute is written clearly, "we are *never certain* that tomorrow we shall still have the rules we have today." BRUNO LEONI , FREEDOM AND THE LAW 75 (3d. ed. 1991)(emphasis in original). *See also* N. Stephan Kinsella, *Legislation and the Discovery of Law in a Free Society*, 11 J. LIBERTARIAN STUD. 132 (1995), available at http://www.mises.org . On the impact of judicial corruption on political risk analysis as it pertains to investments, *see* Luis Enrique Cuervo & Vernon Valentine Palmer, *Judicial Protection of Foreign Investors in Latin America: Exposé des Motifs*, 77 TUL. L. REV. 1053, 1054 (2003).

1.07 For purposes of investors concerned with political risk, the primary distinction to be made is between detriment (loss) proximately caused by the host State or its agents, and that caused by the commercial realities of supply and demand or by natural disaster. This line is far harder to draw in practice than in theory: the scenarios investors face in carrying out a long-term business project on foreign soil are complex and affected by a range of factors both within and outside government control.[9]

B. Political Risk and Property Rights

1.08 Since political risk involves State interference with investors' property rights, an understanding of "property" and "property rights" is an important part of any analysis of political risk.[10] "Property" is a broad concept that includes, in common-law terminology, realty and personalty, and tangibles and intangibles such as rights under contracts. In civil-law terminology, property consists of "things," which may be divided into the corresponding categories of immovables and movables, and corporal and incorporeal.[11] The term "property rights," as used in this text and as commonly understood, refers to ownership of property, which comprises three elements or ingredients: *usus* (the right to use), *fructus* (the right to the fruits of property, such as interest or rentals), and *abusus* (the right to dispose of or sell the property). The common law regards property rights as a similarly-divided "bundle" of rights, the major components of which are the rights to control, possess, use, exclude, profit, and dispose of property.

1.09 For example, for an investor who owns a manufacturing plant, property rights include: (a) ownership of the land, the factory on the land, and the inventory and equipment located in the factory; (b) the right to use the factory to manufacture the goods that the investor deems profitable; (c) the right to manage its business as it deems proper; (d) the right to sell goods and capital assets; and (e) the right to repatriate those proceeds. Each of these elements may be vital to the investor's ability to obtain a reasonably-expected rate of return on investment. A wide range of government actions and non-actions can alter or diminish any of these rights, and therefore should form part of any comprehensive political risk analysis. Examples of State interference with the investor's private property rights include:

- confiscation of the investor's real and personal property;
- refusal to allow the investor to remove equipment from the host state;

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9 Georgio Sacerdoti, *The Source and Evolution of International Legal Protection for Infrastructure Investments Confronting Political and Regulatory Risks*, 5(7) CEPMLP JOURNAL, at 4–5.

10 The conceptual aspects of property under international law remain relatively unexplored. Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS [R.C.A.D.I] 259, 268 (1982) (complaining that "it is as if we international lawyers say: property has been defined for us by our municipal legal system; and in any event, we *know* property when we see it").

11 *See* N. Stephan Kinsella, *A Civil Law to Common Law Dictionary*, 54 LA. L. REV. 1265 (1994), available at http://www.KinsellaLaw.com . In *Libyan American Oil Company v. Libyan Arab Republic*, Sole Arbitrator Mahmassani discussed concession rights as forming part of the incorporeal (i.e., intangible) property of the investor. *Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic*, 62 I.L.R. 140, 189 (1980), 20 I.L.M. 1, 53 (1981).

- imposition of regulation or taxes to such a degree that the investment becomes practically worthless or economically unfeasible;
- legislation compelling transfer of technology or permitting violations of the investor's intellectual property rights;
- repudiation or forced renegotiation of a contract between a State-owned entity and the investor;
- non-payment of debt owed to the investor;
- imposition of unexpected controls on the conversion or export of local currency;
- unfair calling of performance on a bond or letter of credit by the host government; and
- loss of assets or contract rights due to war, civil war, insurrection, terrorism, or other unrest.

Political risk comprises scenarios such as these, where the host government undermines the enjoyment of the investment more drastically than was anticipated at the time the investment was made.[12]

1.10 Why is political risk so prevalent, such a real and necessary part of business planning? One widely accepted explanation, known as the "obsolescing bargain" theory, suggests that the very nature of investment and the effect of risk drives governments to increase interference or decrease support over time vis-à-vis foreign investment.[13] At the outset of a project, foreign investors tend to demand additional concessions or higher returns as a result of the perceived risks of entry and the intensive exposure of the start-up phase. Once the investment is underway, however, the host government is less prepared to maintain the start-up conditions, since the risk often will have declined, along with the cost of financing. Where a project is long-term with heavy capital investment (sunk costs) at the start, and uses assets that are not easily sold or converted to other purposes, the government has a great deal of leverage over the foreign investor, who cannot credibly threaten to abandon his investment plans if conditions deteriorate. This imbalance creates an almost irresistible temptation for local officials to extract short-term political advantage by shifting foreign investment profits to constituents either within the government or the public at large.[14]

1.11 The societal pressure that can lead to unpredictable intervention in foreign-owned investment by host States is often intensified by domestic perceptions about the way the benefits of investment are distributed between the foreigner and the local population. Depending on the type of project, benefits in terms of poverty alleviation in developing countries can be diffuse and indirect. As a result, local populations may question the equity of

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12 *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of March 9, 1998 at para. 103, 40 ILM 36 (2001) (expropriation occurs whenever government interference with property has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property).

13 RAYMOND VERNON, IN THE HURRICANE'S EYE: THE TROUBLED PROSPECTS OF MULTINATIONAL ENTERPRISES 32–59 (1998).

14 About the "obsolescing bargain" theory in the power sector, *see* PAPANASTASIOU, *supra* note 6, at 19-20.

favorable conditions offered to the foreign investor. This problem can be particularly acute in oil and gas exploitation, which greatly benefits direct participants but sometimes has little effect on employment, services, and other activity in other sectors of the economy.[15] We will address this problem in detail below.

C. Types of Political Risk

1.12 For analytical purposes, we identify several types of political risk. Other observers have categorized these risks differently, and often certain potential outcomes or government acts straddle two or more parts of the typology.[16] The main categories of risk include: (1) outright expropriation (including confiscation and nationalization), (2) regulatory interference (including indirect and creeping expropriation), (3) currency risk, (4) civil unrest, (5) breach of State contracts, (6) corruption, and (7) trade restrictions. While these distinctions are useful in understanding the nature of political risk and its various manifestations, the distinction between types is often blurred in actual situations, which may involve elements from more than one of these seven groups. There is also an increase in new types of political risk, particularly in the infrastructure industry, as ''on going sources of threat''.[17] In addition, the involved role of PRI agencies in covering risks such as the devaluation risk, which ''do not readily fall under the established political risk categories'', provoke some more uncertainty in determining the political risk notion.[18]

1. Expropriation, Nationalization, and Confiscation

1.13 "Expropriation" is the taking by a host state of property owned by a foreign investor and located in the host State. In a classic expropriation, the state accomplishes the "taking" by acting under local law to annul the investor's title to or beneficial ownership of the property in question. The taking can, if necessary, be implemented through the use of force against the investor. Professor Wortley elaborates upon the definition of expropriation:

> When, by the action of State E, O, an owner, is expropriated, the legal bond between O and the thing claimed by him is severed by the law of State E, and, *by that law*, O is no longer regarded as having an enforceable claim to the thing expropriated; State E thenceforward accords to itself, or to its nominee, the protection of an owner in respect of the thing taken.[19]

1.14 As Professor Brownlie has explained, "the essence of the matter is the deprivation by state organs of a right of property either as such, or by permanent transfer of the power of management in control."[20]

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15 Jonathan Walters, *Caspian Oil and Gas: Mitigating Political Risks for Private Participation*, 7(5) CEPMLP J. at 2–3 (2001), available at http://www.dundee.ac.uk/cepmlp/journal .

16 The main problem is that political risks are quite ''heterogeneous'' in nature; *See* Claire A. Hill, *How Investors React to Political Risk*, 8(2) Duke Journal of Comparative and International Law 288-313 (1998).

17 MORAN, supra note 7, at 7.

18 Tomoko Matsukawa and Odo Habeck, *Review of Risk Mitigation Instruments for Infrastructure Financing and Recent Trends and Developments*, Trends and Policy Options Paper no. 4, PPIAF, World Bank 7 (2007).

19 B.A. WORTLEY, EXPROPRIATION IN PUBLIC INTERNATIONAL LAW 1 (1959).

20 IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 508–509 (2003).

1.15 Examples of expropriation of movable property abound in the context of the Iran-U.S. Claims Tribunal,[21] including the *Pereira* case,[22] where Iranian Revolutionary Guards confiscated the contents of the claimant's office and a company car, and in which case the State was ordered to pay damages in the amount of the value of the property. In *Leonard and Mavis Daley* ,[23] Iranian Revolutionary Guards confiscated a car and a Rolex watch, and Iran was ordered to pay compensation. Later examples of classic expropriation of ongoing enterprises can be found in the *AGIP* ,[24] *Benvenuti* ,[25] and *Amco Asia*[26] arbitral decisions, all of which involved joint ventures between foreign investors and states or state agencies that were forcibly taken over by military action of the host state. In *AGIP*, an oil distribution business was nationalized by legislation, then the company's headquarters were occupied by Congolese army troops. In *Benvenuti*, the Congolese army seized and occupied a plastic bottle factory and water bottling plant. In *Amco Asia*, the Indonesian army seized a hotel complex belonging to U.S. investors. In each of these cases, a tribunal found that the State's actions violated internationally-recognized ownership rights and ordered that damages be paid to the aggrieved investors.

1.16 A once-common form of expropriation applied to ongoing enterprises was to confiscate a controlling share of equity in a holding company that owned the enterprise. Examples of expropriation by taking shares of foreign investors can be found in *American International Group*[27] and *INA Corp v. Iran* .[28] In both of these cases, the Iranian government seized claimants' shares of Iranian insurance companies pursuant to the 1979 law of nationalization of insurance and credit enterprises.[29]

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21 The Iran-U.S. Claims Tribunal was established on January 19, 1981 under the Algiers Accords to resolve disputes between nationals of the U.S. and Iran and the opposite government arising out of allegations of interference with property rights. Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran (Claims Settlement Declaration), 1 Iran-US C.T.R. 9, 15 (1981–82).

22 *William L. Pereira Associates, Iran (Pereira) v. The Islamic Republic of Iran*, Awd. No. 116-1-3, 5 IRAN-U.S. C.T.R. 198 (1984).

23 *Leonard and Mavis Daley v. The Islamic Republic of Iran*, Awd. No. 360-10514-1, 19 IRAN-U.S. C.T.R. 232 (1988).

24 *AGIP SpA v. Government of the People's Republic of the Congo*, ICSID Case No. ARB/77/1, Award of Nov. 30, 1979, 21 I.L.M. 726 (1982).

25 *S.A.R.L. Benvenuti & Bonfant v. Government of the People's Republic of the Congo*, ICSID Case No. ARB/77/2, Award of August 8, 1980, 67 I.L.R. 345 (1984).

26 *Amco Asia Corp., Pan American Development Ltd., and P.T. Amco Indonesia v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Award of November 20, 1984, 24 I.L.M. 1022 (1984).

27 *American International Group, Inc., et al. (AIG) v. The Islamic Republic of Iran*, Awd. No. 93-2-3, 4 IRAN-U.S. C.T.R. 96 (1983).

28 *INA Corp v. The Government of the Islamic Republic of Iran*, Awd. No. 184-161-1, 8 IRAN-U.S. C.T.R. 373 (1985).

29 The Government of the Islamic Republic of Iran nationalized banks on June 7, 1979, insurance companies on June 25, 1979, and certain heavy industries beginning on July 5, 1979. Thus, the two cases mentioned are not only examples of direct expropriation, but also of nationalization, discussed in Section C.1.b *infra*.

1.17 It is important to note at the outset that at customary international law, States bear no international liability towards *domestic* investors for the expropriation of their property.[30] Thus, the international law of expropriation deals only with expropriation of property of an investor with a nationality other than that of the host state. Where the investor is a physical person with potentially more than one nationality, the "effective nationality" rule traditionally determines which citizenship is controlling for purposes of diplomatic protection. According to this rule, a person is considered a national of the State with which he has the closest factual connection.[31] In the case of a corporate investor, the place of incorporation and other formal indicia of citizenship generally supply the relevant nationality under international law.[32]

1.18 Some expropriations are considered "legal" and some "illegal" under international law.[33] Expropriation is considered "legal" only if it is: (1) non-discriminatory; (2) carried out for a public purpose; and (3) accompanied by full compensation.[34] Although the distinction between "legal" and "illegal" expropriations is of limited significance as a factor influencing the amount of compensation due to an investor following expropriation,[35] whether an expropriation is "illegal" can be relevant for certain other reasons. First, many States will be reluctant to undertake actions that are considered to be illegal under international law. Also, some national laws concerning expropriation, such as the act of State doctrine in the United States, provide for different results depending upon whether the expropriation is "legal" or "illegal" under international law.[36] Further, according to a traditional view, illegality may offer the investor the

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30 *See* Chapter 4, Section F; also *Banco Nacional de Cuba v. Farr*, 383 F.2d at 185; *Banco Nacional de Cuba v. Sabbatino* , 307 F.2d 845, 861 (2d Cir. 1962), *rev'd on other grounds*, 376 U.S. 398 (1964). This fundamental premise has been altered in the case of the first Protocol to the European Convention on Human Rights, which requires member States to respect the sanctity of individual property rights of locals and foreigners alike. For a useful overview of the law of expropriation under the Convention, *see* Elyse M. Freeman, *Regulatory Expropriation under NAFTA Chapter 11: Some Lessons from the European Court of Human Rights*, 42 COLUM J. TRANSNAT'L L. 177 (2003); Helen Mountfield, *Regulatory Expropriations in Europe: The Approach of the European Court of Human Rights*, 11 N.Y.U. ENVIRON. L. J. 136 (2003); Hélène Ruiz Fabri, *The Approach Taken by the European Court of Human Rights to the Assessment of Compensation for "Regulatory Expropriations" of the Property of Foreign Investors*, 11 N.Y.U. ENVIRON. L.J. 148 (2003); *See* also, José E. Alvarez, *The Use (and Misuse) of European Human Rights Law in Investor-State Dispute Settlement,* in THE IMPACT OF EU LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 72 (FRANCO FERRARI ed., 2017), available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2875089.

31 *Nottebohm Case* (Lichtenstein v. Guatemala) 1955 ICJ 4, 23 (1955); *Merge Claim*, 22 ILR 443, 455, Ital.-U.S. Concil. Comm'n (1955). *See also* Chapter 4, Section F.1.

32 *Barcelona Traction Case* (Belgium v. Spain), 1970 ICJ 5, 46 I.L.R. 178, available at http://www.icj-cij.org . The *Barcelona Traction* rule allows for four exceptions where formal criteria can be ignored for purposes of corporate nationality: (1) equitable concerns; (2) where the state under whose protection the corporation would naturally fall is unable to act; (3) where the state of incorporation itself is the tortfeasor, the state in which a large shareholders resides may be able to exercise diplomatic protection; and (4) where the corporation has since gone out of business. *See also Tokios Tekelés v. Ukraine* , ICSID Case No. ARB/02/18, Decision on Jurisdiction of April 29, 2004, available at http://www.worldbank.org/icsid (absent fraud, the place of incorporation of the corporate claimant should be respected for purposes of nationality), Chapter 4, Section F.

33 This topic is discussed in detail in Chapter 5.

34 *See* Chapter 5, Section B.

35 *See* Chapter 5, Section B.

36 *See* Chapter 4, Sections G.2.c and G.3; also UNCTAD, *Taking of Property*, UNCTAD/ITE/IIT/15 (2000), available at http://www.unctad.org/en/docs/psiteiitd15.en.pdf, at 24 *et seq.*

right to demand restitution of property, rather than only damages in compensation.[37] Finally, some political risk insurance contracts require that an expropriation be "illegal" under international law before a claim may be made on the policy.[38]

1.19 The risk of expropriation is typically greater in high-profile, capital intensive infrastructure or natural resources projects, such as oil projects, mining projects, and power projects. [39]As explained above, these projects are most vulnerable to the "obsolescing bargain" problem. Furthermore, governments stand to gain a great deal politically from taking over investments such as these, which are widely seen as providing essential services or based on "national patrimony." Expropriation is also more prone to occur in times of political instability, such as prevailed following the systemic changes in Cuba in 1959[40] and Iran in 1979. Additionally, because expropriation involves the annulment of property rights, it is also more likely to occur in States lacking an extensive tradition of broad-based private property ownership. An analysis of the history, legal and political institutions, and prevailing philosophy and culture of the host state can shed some light on the State's ability to withstand the socio-political pressure to expropriate.

1.20 Before turning to the next category of political risk, some comment is in order regarding terminology in the area of expropriation. The word "nationalization" is often used interchangeably with "expropriation." Technically speaking, however, the terms can be seen to differ: nationalization is a specific form or manifestation of expropriation. Nationalization generally refers to a sweeping government policy to take over *all* foreign investment, or all foreign investment within a particular industry, for the purpose of social or economic reform.[41] Professor Renato Ribeiro explains that an "expropriation" takes place when the state "takes possession of personal, individually-held assets and rights of foreigners and usually makes prompt and fair payment for them," while a "nationalization" is a "general, impersonal form of expropriation which the state uses in the larger interests of society to advance a program of economic and social reform." Its purpose is "to have the ownership of wealth and natural resources, as well as the means to production, perform a social function."[42] Examples of nationalizations include the takeover of the banking and insurance industries by Iran in June

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37 *See* Chapter 10, Section E.

38 *See* Chapter 3.

39 *See, e.g.*, Chapter 5, Section A.2.b for a discussion of Libya's nationalization of its oil industry in the 1970s.

40 *See* ERIC N. BAKLANOFF , EXPROPRIATION OF U.S. INVESTMENT IN CUBA, MEXICO, AND CHILE (1975).

41 Richard M. Mosk, *Expropriation: What to Do About It?*, 5 CAL. INT'L PRACT. 11 (1993–94). For a further discussion of the distinction between expropriation and nationalization, see Wortley, *supra* note 19, at 93 ("The word 'nationalization' is not a term of art, but it usually signifies expropriation in pursuance of some national political programme intended to create out of existing enterprises, or to strengthen, a nationally controlled industry. Nationalization differs in its scope and extent, rather than in its juridical nature from other types of expropriation"); BROWNLIE, *supra* note 20, at 509 ("Expropriation of one or more major national resources as part of a general programme of social and economic reform is now generally referred to as nationalization …"); ISI FOIGHEL , NATIONALIZATION: A STUDY IN THE PROTECTION OF ALIEN PROPERTY IN INTERNATIONAL LAW 19 (1957) ("nationalization" is "the compulsory transfer to the state of private property dictated by economic motives and having as its purpose the continued and essentially unaltered exploitation of the particular property").

42 RENATO RIBEIRO, NATIONALIZATION OF FOREIGN PROPERTY IN INTERNATIONAL LAW i (1977).

of 1979 following the Islamic Revolution[43] and Chile's appropriation of American copper interests in 1971.[44] Widespread nationalization also occurred in Peru in 1968, when the government seized the International Petroleum Company's holdings, as well as a range of mining companies, sugar producers, and banks.[45] A more recent example of nationalizations existed in Venezuela where President Hugo Chavez promoted a nationalization program in multiple sectors, especially in the oil and minerals extracting industry.[46]

1.21 Finally, the term "confiscation," when used to differentiate from other forms of expropriation, refers to the State seizure of property without compensation, usually to punish the owner for who he is or for what he has done.[47] J.E.S. Fawcett defined confiscation as "the taking of private property by the state without payment or compensation[48] to the divested owner."[49] Beginning in 2002, confiscation shook the social and economic structure of Zimbabwe. There, the Mugabe government initiated a "land reform" program to transfer agricultural land to the "native" population, in part by encouraging paramilitary groups to take the land from farmers of European origin.[50]

1.22 Regardless of the terminology or the precise form of State action, the result of expropriation is uniform. The assets that the foreign investor has brought to the host country, or those he has acquired there to undertake a business enterprise, are transferred to the local government or its designee, or simply dissipated or destroyed. It is important to recognize the sea change that has transpired over the past decades to reduce this particular political risk to a shadow of its former self. As Rudolph Dolzer explains,

> In this period of globalization, decreased official development aid and increased privatization and liberalization, formal expropriation has become anathema for developing states. The former concepts of economic decolonization and permanent

43 *See, generally, INA Corp., supra* note 28, and *AIG* , *supra* note 27

44 Following the election of Salvadore Allende in Chile in 1971, the Chilean Congress expropriated copper mines owned by two American companies, Kennecott Copper Corporation and Anaconda Copper Company. Evrett W. Benton, *The Libyan Expropriations: Further Developments on the Remedy of Invalidation of Title*, 11 HOUS. L. REV. 924, 935 (1974). *See also* BAKLANOFF, *supra* note 40.

45 Amy L. Chua, *The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries*, 95 COL. L. REV. 223, 239 (1995).

46 PAPANASTASIOU, *supra* note 6, at 53.

47 Matias F. Travieso-Diaz, *Some Legal and Practical Issues in the Resolution of Cuban Nationals' Expropriation Claims Against Cuba*, 16 U. PA. J. INT'L BUS. L. 217, 229–30 (1995). BROWNLIE, *supra* note 20, at 509 ("if compensation is not provided, or the taking is regarded as unlawful, the taking is sometimes described as confiscation"); BLACK'S LAW DICTIONARY (6th ed. 1990) defines "confiscation" as "the seizure of private property by the government without compensation to the owner, often as a consequence of conviction for crime, or because possession or use of the property was contrary to law." *See also Am. Ins. Ass'n v. Garamendi* , 539 U.S. 396 (2003) (U.S. Supreme Court referred to Nazi Germany's seizure of private assets as "confiscation").

48 *British Petroleum Exploration Company (Libya) Limited v. Government of the Libyan Arab Republic*, 53 I.L.R. 297, 329 (1973) ("the fact that no offer or compensation has been made indicates that the taking was also confiscatory").

49 J.E.S. Fawcett, *Some Foreign Effects of Nationalisation of Property*, 27 BRIT. YB. INT'L L. 355 (1950).

50 *Zimbabwe: Attempted Farm Eviction*, N.Y. TIMES, Aug. 15, 2002 at A13; HUMAN RIGHTSWATCH, FAST TRACK LAND REFORM IN ZIMBABWE, March 2002, available at http://www.hrw.org/reports/2002/zimbabwe .

sovereignty over natural resources have—in theory and, in many corners, in practice—been replaced by structural adjustment, good governance, export-led growth and vivid competition for foreign investment.[51]

1.23 This is not to say that governments no longer engage in outright seizure of foreign property. In 1994, for example, Boris Yeltsin issued a decree allocating certain buildings in a particularly picturesque part of St. Petersburg to be used as accommodations for visiting dignitaries. The facilities, however, were owned by a Russian-German joint venture that provided private security services and sold police equipment. After extended judicial and administrative battles, the local authorities entered the property in 1996, sealing the premises and forcing employees of the joint venture to leave with only their personal belongings. The German investor left Russia on a ferry shortly thereafter, leaving behind even his car and personal computer. An arbitration tribunal formed under the aegis of the Germany-Russian bilateral investment treaty later found that Russia had directly expropriated buildings, automobiles, and other property in violation of international law obligations.[52]

1.24 But if in the 1960s and 1970s outright expropriation was one of the most prominent political risks that foreign investors feared and sought to mitigate, today it has receded to the remote horizon. Instead, developing States have adopted from the industrialized world more subtle means of wealth redistribution and economic control, giving rise to a very real modern-day risk of "de facto" expropriation by regulation.[53]

2. Regulatory Interference

1.25 Thus, the greater contemporary risk to foreign investors is government interference that does not formally transfer title away from the investor, but damages or destroys his ability to control or benefit from the investment he has made. Government measures that eliminate substantially all of an investment's value may constitute regulatory expropriation, including creeping or indirect expropriation—where a series of State acts accumulates to deprive an investment of its value.[54] Such State actions can deprive the investor of the productive use and

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[51] Rudolph Dolzer, *Indirect Expropriations: New Developments?*, 11 N.Y.U. ENVIRON. L. J. 64, 65 (2003).

[52] *Sedelmayer v. Russian Federation* , *ad hoc* tribunal, Award of July 7, 1998. Another direct expropriation took place in Latvia in 1996. In *Swembalt SA v. Latvia* , a Swedish company brought a ship to Riga as a floating Swedish commercial center. The port authorities, claiming that municipal officials had not been authorized under local law to issue the necessary permits, towed it from its mooring and eventually sold it at auction for scrap. *Swembalt SA v. Latvia*, UNCITRAL Award of October 23, 2000, 2004(2) STOCKHOLM ARB. REP. 97.

[53] *See* C Yannaca-Small, "Indirect Expropriation" and the "Right to Regulate" in International Investment Law, OECD Working Paper on International Investment no. 2004/4 (2004).

[54] While the phrase "de facto expropriation" is perhaps a better description than "creeping expropriation" or "indirect expropriation" (Robert B. Shanks, *Insuring Investment and Loans Against Currency Inconvertibility, Expropriation, and Political Violence*, 9 HASTINGS INT'L & COMP. L. REV. 417, 424 (1986)), the latter terms have received widespread acceptance and will be used more frequently in this book. "Creeping expropriation" stresses that the State has taken a series of measures with a cumulative expropriatory effect, while "indirect" emphasizes the fact that the investor's formal or nominal title to the asset was not actually affected. In practice, much *de facto* expropriation is both "creeping" and "indirect." On regulatory expropriation generally, *see* Jack Coe, Jr & Noah Rubins, *Regulatory Expropriation and the Tecmed Case: Context and Contributions*, INTERNATIONAL INVESTMENT LAW AND ARBITRATION 597 (Todd Weiler, ed. 2005); Sean D. Murphy, *Contemporary Practice of the United States relating to International Law*, 95 A.J.I.L. 873, 881–885

benefit of its assets, making ownership practically worthless, even though the investor may retain formal attributes of ownership.[55] In the *Starrett* decision, the Iran-U.S. Claims Tribunal explained that

> Measures taken by a state can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal title to the property formally remains with the original owner.[56]

1.26 Some define "creeping expropriation" as government measures that impose incremental restrictions and controls (such as excessive or repetitive regulatory measures) to make it difficult for the investor to continue in business at the profit level that justified the project in the first place.[57] Such government measures may lead to the sale or abandonment of the project to the government or to local private investors,[58] but the government may obtain no obvious direct benefit. Although each measure in isolation may not be enough to damage the investor's rights in any fundamental way, the cumulative effect of the measures can nevertheless be confiscatory, depriving the investor of control or a substantial portion of the benefits of his enterprise.[59]

1.27 As we will see later, whether a host government's measures result in "expropriation" within the definition of customary international law is largely a function of the depth of the harm to the foreign investor. The legal analysis is complicated, however, by the recognition of commentators and arbitrators that regulation is central to any State's responsibility to its populace. Only by exercising their "police power" can governments protect health and safety, maintain order, and try to increase prosperity, although all of these actions may also have a deleterious impact on foreign investment. According to some, customary international law will not impose liability where a State has enacted generally-applicable regulation for a "legitimate" purpose.[60] The *ad hoc* tribunal in *CME v. Czech Republic* emphasized the possibility of non-

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(2001); UNCTAD, *Taking of Property*, *supra* note 36, at 11–12. *See also Methanex Corp. v. United States* , Final Award on Jurisdiction and Merits of Aug. 3, 2005 (NAFTA Chapter 11), available at http://www.state.gov/documents/organization/51052.pdf, at Part IV-Chapter D, paras. 6–7 (non-discriminatory regulations for a public purpose, such as environmental laws, not considered expropriation).

55 Noah Rubins, *Must the Victorious Claimant Relinquish Title to Expropriated Property?*, 4 J. WORLD INV. 481 (2003).

56 In other decisions, such as *Golpira v. Iran*, Awd. No. 32-211-2, 2 IRAN-U.S. C.T.R. 171, 177 (1983) and *International Technical Products Corp v. Iran*, Awd. No. 196-302-3, 9 IRAN-U.S. C.T.R. 206 (1985), the Iran-U.S. Claims Tribunal found expropriation based on an unreasonable interference with the use and control of property of U.S. nationals.

57 Robert B. Shanks, *Insuring Investment and Loans Against Currency Inconvertibility, Expropriation, and Political Violence*, 9 HASTINGS INT'L & COMP. L. REV. 417, 424 (1986).

58 *CME Czech Republic, S.A. v. Czech Republic*, UNCITRAL Final Award of March 13, 2003.

59 Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Prospective*, 27 VAND. J. TRANSNAT'L L. 259, at n276 (1994). *See also* Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV.—FOR. INV. L.J. 41 (1986), and Detlev F. Vagts, *Coercion and Foreign Investment Rearrangements*, 72 A.J.I.L. 17 (1978); Yves Fortier, *Caveat Investor: The Meaning of "Expropriation" and the Protection Afforded Investors under NAFTA*, News from ICSID, Summer 2003 at 1, 10. *See also* Chapter 3, Section A.2.b (discussing OPIC's definition of creeping expropriation).

60 BROWNLIE, *supra* note 20, at 508–509.

compensable harm from regulation in an award finding that the Czech government's failure to preserve a Dutch investor's broadcast license constituted expropriation:

> Of course, deprivation of property and/or rights must be distinguished from ordinary measures of the State and its agencies in proper execution of the law. Regulatory measures are common in all types of legal and economic systems in order to avoid use of private property contrary to the general welfare of the (host) State.[61]

1.28 The U.S. Restatement on Foreign Relations Law likewise summarizes this view of customary law:

> A state is not responsible for loss of property or for other economic disadvantage resulting from *bona fide* general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory.[62]

As a result of this approach, some early arbitral decisions focused upon the intent of the State in adopting the measure in question.[63]

1.29 However, later decisions, beginning with those of the Iran-U.S. Claims Tribunal, have downplayed the question of government "intent" in determining the legal effect of regulatory measures. In *Tippets*, for example, the Tribunal concluded that

> The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.[64]

1.30 The role of intent has further diminished since then. In arbitration under bilateral and multilateral investment treaties, tribunals have repeatedly discounted the purpose of a regulatory measure as a consideration for expropriation analysis.[65] One of the strongest statements of this position came in the *Santa Elena* case, where the Costa Rican government had effectively ejected the foreign investor from his land by designating the property as part of a nature preserve:

> Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measure

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61 *CME Czech Republic, B.V. v. Czech Republic*, UNCITRAL Partial Award of Sept. 13, 2001 at para. 603, available at http://www.investmentclaims.com/decisions/CME-Czech-Partial Award-13Sept2001.pdf .

62 UNITED STATES RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712.

63 *Oscar Chinn*, P.C.I.J., Ser. A/B, no. 63 (1934); *Sea-Land Serv., Inc. v. Iran*, 6 IRAN-U.S. C.T.R. 149, 166 (1984). *See also* BROWNLIE, *supra* note 20, at 509; Burns H. Weston, *"Constructive Takings" Under International Law: A Modest Foray into the Problem of Creeping Expropriation*, 16 VA. J. INT'L L. 103, 170 (1975) ("deference should be given to the original intent of the administrating government and, thus, to the broad 'regulatory' competence that States traditionally have enjoyed under international law"). *But compare* BROWNLIE, *supra* note 20, at 509 (taxation designed to confiscate may be considered expropriation at international law); BRITISH PRACTICE IN INTERNATIONAL LAW 202–206 (Eli Lauterpacht ed., 1964) (same).

64 *Tippets, Abbett, McCarthy, Stratton (Tippets) v. TAMS-AFFA Consulting Engineers of Iran*, Awd. No. 141-7-2, 6 IRAN-U.S. C.T.R. 219, 225–226 (1984). *See also Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, Awd. No. 217-99-2, 10 IRAN-U.S. C.T.R. 121 (1986).

65 *Metalclad*, *supra* note 12, at para. 111.

that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.[66]

1.31 Clearly, this trend is the result of a practical recognition that regulation is rarely enacted for only one purpose, or even for a single dominant purpose. Furthermore, the evidentiary burden on the claimant and the tribunal in establishing requisite intent makes such a criterion counterproductive in many instances. Nevertheless, the exclusion of purpose and intent from expropriation analysis is currently the subject of much debate in the academic community: many suggest that a view of indirect expropriation that focuses exclusively upon effects will deter host governments from undertaking necessary regulatory action, especially in the field of environmental law.[67] We will return to this contentious issue later in the book, when we present the substantive international law of investment protection, as well as when we examine the interaction between the international investment law and the international human rights law.

1.32 There is a practically limitless range of regulatory measures that can potentially harm or even destroy foreign investment. One of the simplest and most common is the withholding of promised operation permits. In many instances, sunk costs cannot be recovered in large-scale investment projects, because they are invested in single-purpose equipment or facilities. In several cases, host governments have encouraged foreign investors to establish operations within their territory, only to withdraw their support for the project later. In *Metalclad* , Mexican federal authorities assured the foreign investor that all necessary permits for a landfill enterprise had been granted, but allowed municipal authorities to thwart the opening of the facility.[68] The *Tecmed* case involved similar circumstances, where a privatized landfill was deprived of its license soon after it came into foreign hands.[69] In *Santa Elena*, meanwhile, U.S. investors obtained permission to build a tourist complex in Costa Rica, but the government later changed its mind and designated the site as part of a nature preserve.[70]

1.33 Another form of indirect expropriation occurs when the State effectively takes control of the foreign-owned investment vehicle by enacting legislation restricting control over corporate management. Iran imposed regulatory measures widely after 1979 replacing the management

66 *Compañia de Desarrollo de Santa Elena, S.A. v. The Republic of Costa Rica* , ICSID Case No. ARB/96/1, Final Award of February 17, 2000 at para. 71–72, 15 ICSID REV.—FOR. INV. L.J. 169 (2000). *See alsoAntoine Goetz v. République du Burundi* , ICSID Case No. ARB/95/3, Decision of Feb. 10, 1999 at para, 124, 15 ICSID REV.—FOR. INV. L.J. 457, 513 (2000); *but cf. Methanex*, *supra* note 54. It should be noted that the intent of the state may remain relevant in determining whether an expropriation is "legal" or "illegal" under international law, once it has been determined that a taking has occurred. *See* Chapter 5, Section B.1.

67 *See* Howard Mann, *NAFTA and the Environment: Lessons for the Future*, 13 TUL. ENVTL. L.J. 387, 405–406 (2000); Daniel R. Loritz, *Comment: Corporate Predators Attack Environmental Regulations: It's Time to Arbitrate Claims Filed Under NAFTA Chapter 11*, 22 LOY. L.A. INT'L & COMP. L. REV. 533, 546–547 (2000) (stating that while environmental regulations should remain legal under NAFTA, the mere threat of suit for multimillion dollar damages chills regulatory activity); Joel C. Beauvais, *Student Article: Regulatory Expropriations Under NAFTA: Emerging Principles & Lingering Doubts*, 10 N.Y.U. ENVT'L. L.J. 245 (2002).

68 *Metalclad, supra* note 12.

69 *Técnicas Medioambientales Tecmed, supra* note 8.

70 *Compañia del Desarrollo, supra* note 66.

of foreign corporations with government-appointed managers and directors.[71] While such action is not a direct expropriation of assets, in several cases it was held to have the same effect as expropriation, depriving the owners of the right to use their property. This may be distinguished from the direct seizure of a controlling share of the entity that holds the investor's assets, which is perhaps more correctly classified as direct expropriation.[72]

1.34 Although the point at which the host State's regulatory actions constitute expropriation under international law may not always be clear, the investor can mitigate the effects of certain potential regulatory measures by including “stabilization clauses” in State contracts. This sort of agreement provides that the law of the host State in effect on the date of the contract will govern the parties' relationship, regardless of future changes made to the law.[73] The investor may also negotiate more specific assurances from the host State that particular regulations will not be imposed. If the investor is able to obtain such assurances, then regulations later imposed in violation of the stabilization clause would be subject to the dispute resolution provisions of the investment contract—normally international arbitration.[74] Investors may also consider obtaining insurance against the imposition of particular taxes and regulations.[75] These topics and strategies are discussed in further detail in this text.

1.35 The variety of regulatory interference is well demonstrated in the following hypothetical case based on an actual situation, where U.S. investors owned just under half of the shares in a fishing joint venture in a host State.[76] Following a coup in the host country, the new government became hostile to both the foreign and local investors. The expatriate manager and his family were threatened with physical harm, and they soon left the country. Next, a foreign refrigeration expert whose services were vital to the joint venture's operations was denied the right to extend his visa; he also was forced to leave. Government authorities then interfered with the joint venture's fishing permits. Harbor authorities refused to allow ships dealing with the joint venture to use port facilities, and it became very difficult for the company to export its catch. Finally, when the investor had been reduced to flying out a single load of

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71 *Starrett Housing Corporation v. Government of the Islamic Republic of Iran*, Awd. No. ITL 32-24-1, 4 IRAN-U.S. C.T.R. 122 (1983); for further discussion, see Charles N. Brower, *Current Developments in the Law of Expropriation and Compensation: A Preliminary Survey of Awards of the Iran-United States Claims Tribunal*, 21 INT'L LAW. 643 (1987).

72 Indirect expropriation may also take the form of a forced sale disguised as a voluntary private sale. In this regard, the effects of the threat of expropriation, if sufficiently severe, may be indistinguishable from the effects of actual expropriation. This form of expropriation was commonly employed by the Nazi regime in Germany. WORTLEY, *supra* note 19, at 1.

73 Such clauses are discussed in detail in Chapter 2, Section D.3. The case of *Occidental Petroleum v. Ecuador* centered around just such a stabilization clause, which specifically froze the Ecuadorean tax regime as of the date of the signing of the investment contract. *Occidental Petroleum Exploration Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award of July 1, 2004. *See also Government of Kuwait v. American Independent Oil Company (AMINOIL)*, 66 I.L.R. 518 (1982).

74 *See* discussions in Chapter 5, Section C, Chapter 4, Sections B and C, and Section C.5, *infra*, regarding breach of contract as a political risk, and the international law consequences of such a breach of contract.

75 Political risk insurance is discussed in Chapter 3.

76 Example supplied in Shanks, *supra* note 57, at 426. This investment was insured by the Overseas Private Investment Corporation (discussed in Chapter 6), which paid on a claim by the investor arising out of the underlying events.

seafood per day on a small company plane, the government refused to permit the joint venture to fly its plane unless it was accompanied by a government approved pilot and "seafood inspector." This extra passenger had the effect of displacing his weight in seafood—a serious problem, given that the "inspector" weighed nearly 200 kilograms, having been selected because he was the heaviest member of the armed forces.

1.36 While this example may well demonstrate sufficient regulatory interference in the investor's operations to constitute expropriation, many situations are not as obvious. Whether interference by a host State rises to the level of expropriation is a fact-intensive inquiry that must be considered on a case-by-case basis.[77] But the risk to the foreign investor remains, even if State measures do not entirely destroy investment value. Customary international law has little to say about non-expropriatory regulatory measures, particularly if foreign investors can challenge their fairness in the host State's courts. As we will see later, however, States have recognized the importance of this category of political risk for FDI, and investment treaties include a number of substantive protections designed to compensate foreign investors where such measures are unreasonable, unfair, or discriminatory.[78]

3. Currency Risk

1.37 Investors who invest directly in a foreign country are particularly vulnerable to a range of alterations in the currency regime. The decision to invest, normally based upon the considered expectation of a reasonable rate of return from foreign-based operations, is closely linked in many ways to interactions between local and international money. Governments frequently implement measures that change the nature of that interaction, measures that can have an important impact on the foreign investor's ability to realize the expected return. Foreign-owned businesses also face the risk that the host State will either prohibit the conversion of local currency revenues into "hard" currency, or otherwise increase controls over the exchange of currency.[79]

1.38 In addition, foreign investors also face the risk of the prohibition of the transfer of funds. For this reason, most investment treaties add a provision for the right to transfer funds in a freely usable currency and at the market rate.[80] However, even if treaties tend to include "absolute statements" related to the protection of the transfer of funds standard, it is argued that the inclusion of such statements is unrealistic and "cannot bind a state in times of financial crisis" or when a contracting party has exchange shortfalls necessitating currency controls.[81]

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[77] A more detailed analysis of the law of expropriation is provided in Chapter 5, and in the context of investment treaties, in Chapter 6.

[78] The substantive protections of fair and equitable treatment, full protection and security, national treatment, and most-favored nation treatment are explained in Chapter 6.

[79] Currency risk cannot be discounted even in the natural resources and commodities sectors, where output is sold in for export and generates foreign currency directly. Jonathan J. Green, *Managing Risks in International Power Projects*, 672 PLI/COMM.L. & PRAC. COURSE HANDBOOK SERIES 669 (1993).

[80] For example, art. 83.2 of the Japan-Malaysia EPA (entry into force July 13, 2006) recognizes that "[e]ach Country shall allow transfers to be made in freely usable currency at the market rate of exchange prevailing on the date of the transfer"; *See* PAPANASTASIOU, *supra* note 6, at 116.

[81] M. SORNARAJAH, INTERNATIONAL LAW OF FOREIGN INVESTMENT 207 (3rd ed. 2010).

1.39 A host country may block conversion either passively, by accepting the investor's application for hard currency at the central bank but blocking the foreign exchange necessary to effect the remittance, or actively, through the imposition of exchange controls or the declaration of a moratorium on exchange.[82] One political risk investment insurance provider, the U.S. Overseas Private Investment Corporation (OPIC), deems currency to be "inconvertible" if the investor is unable to legally convert its earnings from the host country's currency into U.S. dollars for a period of 90 days. But other, less restrictive controls on currency exchange can also present serious pitfalls for foreign investors,[83] particularly those involved in large projects involving intensive, dollar-denominated financing and high volumes of income in local currency, as in electrical generation or highway concessions.

1.40 Investors may also face the risk of currency devaluation brought about by government policies. Thus, upon conversion, such currency may be worth less than expected. Even where inflation and the devaluation of currency are the direct result of government action,[84] such conditions have often been classified as commercial rather than political risk. After the crises in Latin America and Asia, however, this classification has been seriously questioned. Most observers agree that the loss in value of the currencies in those economies was primarily the result of government choices in fiscal and trade policy. In many cases, foreign investors made their decision to invest based in part on such political criteria as government expenditures and tax collection efficiency, the trade balance level, and the existence of infrastructure for sustainable development. During the Mexican crisis of 1996, it was the government's publicly announced cooperation with the International Monetary Fund (IMF) that stopped the exodus of foreign peso holdings. The IMF's purported goal was to ensure the implementation of political reform necessary to stabilize the Mexican economy. Thus, many investors have taken the view that currency risk is a political rather than purely commercial concern.[85]

1.41 Financial crises such as those experienced in Latin America, Russia, and Southeast Asia in the mid- to late-1990s compound currency risks and increase the possibility that the host State will impose new regulations shifting the burden of recovery onto foreign investors. This threat is particularly acute in the public services sector: as the local currency drops in value, enterprises with foreign-denominated costs (particularly debt service obligations) must raise more revenue to maintain previous rates of return. Since public services prices are normally regulated by the

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82 Peter F. Fitzgerald, *Overview of Risks in International Financing*, 707 PLI/COMM.L. & PRAC. COURSE HANDBOOK SERIES 7 (1995).

83 *See, e.g.*, G. H. Yu, *China's foreign exchange regulations and direct foreign investment* 28(6) JOURNAL OF WORLD TRADE 99 (1994); S. Paksoy, *Foreign Investment and Exchange Regulations in Turkey*, 18 COMPARATIVE LAW YEARBOOK OF INTERNATIONAL BUSINESS 241 (1996).

84 On the link between money inflation (inflation of the supply of money and credit by central government policy) and price inflation (which is typically what is meant today by the expression "inflation," but which is caused by, merely a symptom of, money supply inflation), see MURRAY N. ROTHBARD, WHAT HAS GOVERNMENT DONE TO OUR MONEY? (4th ed. 1990), available at http://www.mises.org ; *idem*, MAN, ECONOMY, AND STATE: A TREATISE ON ECONOMIC PRINCIPLES (1962), at ch. 12, § 11 (pp. 850–878), available at http://www.mises.org ; and MISES , HUMAN ACTION, at ch. XXXI *et passim*.

85 Any doubt that currency devaluation is a political risk dissipates when currency devaluation is combined with price controls, which prevent businesses from passing through the cost of devaluation to consumers.

State, but based upon formulae that take costs into account, a government faced with sharply devaluated currency may seek to alter the original formula to prevent the foreign operator from "passing through" increased costs to consumers, and to avoid absorbing the cost of devaluation itself. As noted earlier, this is precisely what occurred in Argentina in 2001–2002, when the government "floated" the peso (once pegged in value at one dollar), which could no longer support an artificial exchange rate. In concert with this move, the Argentine government froze most utility rates, which had been periodically modified according to foreign price indexes. More radically, the government "pesified" contracts, converting dollar obligations into pesos at the previous rate of one-to-one. For foreign investors in public utility providers, this combination was devastating.[86]

1.42 Currency crises, and the resulting imposition of currency restrictions, often occur in developing economies after intense short-term economic expansion. Paradoxically, therefore, foreign investors should pay particular attention to fiscal practices before investing in a booming economy. In particular, currency pressure tends to be cyclical, and a careful examination of the history of government fiscal policies and responses to crisis can give potential investors a reasonable view of possible future outcomes.[87]

4. Civil Disturbance

1.43 In some parts of the world, the risk that civil disturbance will affect foreign-owned commercial operations cannot be ignored. Such a risk subsumes a range of different levels of disorder and violence, from widespread strikes and sabotage to terrorism, riots, revolution, and civil or external war. If the host State proves unable to insulate business interests from the direct and indirect effects of civil strife, investors may find their property damaged or destroyed, or they may be unable to carry on day-to-day operations due to workforce shortages, the threat of violence, or the disruption of connections to supplies or markets. Situations of war also sometimes lead to the commandeering of buildings and factories by government or rebel military forces.

1.44 Unlike many other risks analyzed here, this type of political risk may not be within the control of the host State. Under customary international law, unless it can be demonstrated that the host State has assumed the risk of loss to the investor, it is not obliged to compensate for damage caused by the non-governmental actors such as rioters, rebels, or looters.[88] The

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86 *CMS Gas Transmission Co. v. Argentina* , ICSID Case No. ARB/01/8, Award of May 12, 2005, available at http://ita.law.uvic.ca/documents/CMS_FinalAward_000.pdf

87 PETER B. KENEN, THE INTERNATIONAL FINANCIAL ARCHITECTURE (2001). *See also* William A. Lovett, *Lessons from the Recent Peso Crisis in Mexico*, 4 TUL. J. INT'L & COMP. L. 143 (1996) (identifying as causes of the Mexican financial crisis investor overconfidence and large capital inflows after the signing of NAFTA).

88 Brower, *supra* note 71, at 652. For a more complete discussion of the international law of state responsibility, see Chapter 4. For examples of cases in which a state was held responsible for political violence, *see American Manufacturing and Trading Co. v. Zaire,* ICSID Case No. ARB/93/01 Award of Feb. 21, 1997, 36 I.L.M. 1534 (1997) (under BIT, Zaire held responsible for damage caused to foreign-owned assets by rebel forces); *Computer Science Corporation v. Government of the Islamic Republic of Iran*, Awd. No. 221-65-1 10 IRAN-U.S. C.T.R. 269 (1986) (Government of Iran held responsible for actions of Iranian Revolutionary Committee because

tribunal in *Sea-Land Service, Inc. v. Iran*[89] upheld this principle, stating that "a finding of expropriation would require, at the very least, that the tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea-Land's operation, the effect of which was to deprive Sea-Land of the use and benefit of the investment."[90] In the absence of a specific treaty, contract, or local law providing otherwise, therefore, civil disturbance carries few legal consequences for the host State.[91]However, such risk is usually insurable.[92]

1.45 Furthermore, investment treaties have added a new tool for controlling foreign investors' civil disturbance risk. As we will explain in more detail in Chapter 5, most investment treaties require the host State to provide "full protection and security" to qualifying foreign investors and their assets. While the extent of this obligation is not entirely clear, some tribunals have imposed a "negligence" standard, requiring the State to take all reasonable actions to prevent harm from befalling foreign businesses.[93] Some recent investment treaties explicitly require the host State to provide adequate police protection from civil disturbances.[94]

1.46 With the inclusion of a specific guarantee such as the protection from strife standard, in modern bilateral investment treaties, the host State reaffirms its obligation to protect foreign investments in case of damage suffered due to wars or civil disturbance and it recognizes the right to compensation "effectively realizable, freely convertible and freely transferrable in a freely usable currency".[95]

5. Breach of State Contracts

1.47 An investor who has acquired rights in the host country through a concession, license, or other contract concluded directly with the local government or its instrumentality must remain alert to the possibility that the State will either annul the contract or compel a change in its terms. Repudiation may take the form of a breach of contractual obligations, enactment of laws undermining the purpose or effectiveness of the contract, or passing legislation annulling the contract altogether.[96] State contracts are more susceptible to alteration or breach than private

Committee was a legitimate organ of Government) and *Pereira, supra* note 22 (Government of Iran responsible for expropriatory action where notice of confiscation issued by Revolutionary Guards).

89 *Sea-Land Service*, *supra* note 63.

90 *Id.* at 166. Although this claim did not arise from political violence, the principle would be applicable to such a situation.

91 *Asian Agricultural Products Ltd. [AAPL] v. Sri Lanka*, ICSID Case No. ARB/87/3, reprinted at 30 I.L.M. 577 (1991) (holding that the destruction of a plant in the fight against an insurgent guerrilla warranted compensation under the "full protection and security" provision of the applicable investment treaty, but not under customary international law). Recovery may be possible under the customary international law of state responsibility if the insurgents who destroyed or confiscated the property in question manage to become the government. In this case, acts the insurgents carried out to gain power may be considered acts of State.

92 *See* Chapter 3.

93 *Asian Agricultural Products*, *supra* note 78 at para. 85(B); *CME Czech Republic B.V.*, Partial Award, *supra* note 61 at para. 613, available at http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13Sept2001.pdf .

94 *See, e.g.*, U.S.-Chile Free Trade Agreement, art. 10.4(2)(6), available at http://www.ustr.gov .

95 See art. 103.2 of the Japan-Thailand EPA (entry into force Nov. 1, 2007); *See* also PAPANASTASIOU, *supra* note 6, at 120-21.

96 BROWNLIE, *supra* note 20, at 522–526.

agreements, because under the law of most jurisdictions, they are subject to a separate body of jurisprudence (administrative law) which gives significant weight to public interest concerns in assessing liability for the State's violation of obligations.[97] Many governments require that their own law govern any contracts that they sign with foreign entities, so that their administrative law will be given full effect, and some national laws grant exclusive jurisdiction over administrative law disputes to a specialized court, often known as a Council of State.[98]

1.48 Nevertheless, in many circumstances State contracts can be subject to neutral dispute resolution procedures, and States have been held to standards of contract implementation similar to those applicable in commercial transactions. In the *LETCO* arbitration,[99] Liberia revoked a twenty-year agreement it had signed with a French company, which provided the foreign investor the exclusive right to conduct certain timber operations. An ICSID tribunal ordered Liberia to pay damages for breach of the contract. In the *Himpurna* arbitration, Indonesia attempted to suspend a power plant project involving a foreign investor and the State-owned electric company, PLN. Indonesia insisted that the resulting breach of contract was excused due the country's financial crisis and by operation of the *force majeure* clause of the applicable contract. The Tribunal awarded damages to Himpurna, the foreign investor, as the *force majeure* clause was not triggered by a financial crisis and PLN could not be excused from liability because of its nature as a State-owned corporation.[100]

1.49 Contract rights are normally recognized as assets or "investments" within the definition provided in investment treaties. These rights themselves may therefore be subject to international law requirements of compensation for expropriation. For example, in the *Phillips* case, Iran nullified a joint venture agreement between Iran's state oil company and an American firm. The Iran-U.S. Claims Tribunal there held the government's actions to constitute expropriation.[101]

1.50 In any event, the terms of the State contract itself have a significant impact upon the risk that the State party is likely to breach it, and on the private party's ability to obtain compensation for harm caused by such a breach. In particular, attention should be paid to the

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97 *See* Jody Freeman, *The Contracting State*, 28 FLA. ST. U.L. REV. 155 (2000); Thomas W. Wälde & George N'Di, *Stabilizing International Investment Commitments: International Law versus Contract Interpretation*, 31 TEX. INT'L L.J. 216, 236 & n.83 (1996), version available at http://www.dundee.ac.uk/cepmlp.

98 See for example Le Conseil d' État in France or in Greece.

99 *Liberian Eastern Timber Corporation (LETCO) v. Government of the Republic of Liberia*, ICSID Case No. ARB/83/2, Award of March 31, 1986, and Rectification of June 17, 1986, 26 I.L.M. 647 (1987). *See also Tecnicas Medioambientales Tecmed, supra* note 8 (regulatory action by Mexico effectively ending the economic use of Tecmed's investment was an expropriatory breach of contract, as the affected asset was purely contractual in nature).

100 *See Himpurna California Energy Ltd. (Bermuda) v. PT. (Persero) Perusahan Listruik Negara (Indonesia)*, MEALEY'S INT'L ARB. REP., December 1999 at A-26.

101 *Phillips Petroleum Company Iran v. The Islamic Republic of Iran, The National Iranian Oil Company*, Awd. No. 425-39-2, 21 IRAN-U.S. C.T.R. 79 (1989). *See also* Chapter 5, Section C (discussing breached contract and expropriation); also Chapter 4, Sections B and C; UNCTAD, *Taking of Property*, *supra* note 36, at 37.

governing law and arbitration or forum selection clauses in State contracts, as well as to waivers of State immunity.[102]

1.51 Nevertheless, the State contract repudiation does not necessarily result to violation of international law.[103] With the provision of the umbrella clause in international investment treaties, State contracts (and any other State commitment towards foreign investments) are governed by international law and any breach of those obligations result in State responsibility under international law.[104]

6. Corruption

1.52 The problem of corruption, which has received a great deal of attention in recent years, is an often-ignored segment of political risk. In fact, corruption in the political apparatus of a host State can have a significant impact on the establishment, operation, expansion, and disposal of foreign-owned assets, and should form an important part of political risk analysis. Corruption is generally understood to occur when government officials demand some personal benefit as a condition to fulfilling official functions.

1.53 Most frequently, corruption affects the establishment of investment. Government officials may require payment of a bribe before signing investment agreements, concession contracts, licenses or permits. It is also relatively common practice in some developing countries for foreign investors to pay fees to private or semi-private entities for "access" to important officials, with the understanding that some portion of these funds will find its way into the officials' personal accounts.[105] Other forms of corruption affect the ongoing operations of foreign businesses. For example, unofficial payments may be required in order to participate in tenders for lucrative State contracts, or to gain access to certain internal markets. Commercial disputes may be impossible to resolve favorably in the courts without the liberal application of "incentive money" to judges. The variety of corrupt practices is nearly limitless, and in some places makes fair competition with other market players difficult to achieve.

1.54 The risk created by this sort of systemic corruption are multiplied for investors from certain countries, which have implemented strict anti-corruption laws. These laws impose heavy sanctions and even jail sentences upon corporate officers who make payments of this variety anywhere in the world.[106] Foreign investors must therefore identify with precision not only the risk that their business competitiveness will be adversely affected by corruption, but also the

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102 *See* Chapter 2, Section E.

103 Especially, when the host State acts not in its sovereign capacity but merely as a party to the contract. *See* JESWALD SALACUSE, THE LAW OF INVESTMENT TREATIES 273 (2010); *See* also *Noble Ventures Inc. v. Romania*, ICSID Case No ARB/01/11, Award of Oct. 12, 2005; *Compagnie Generale des Eaux v. Argentine Republic*, ICSID Case No ARB/97/3, Decision on Annulment of July 3, 2002, para. 95.

104 PAPANASTASIOU, *supra* note 6, at 122.

105 For an analysis of the corruption impact in infrastructure projects of developing countries, *see* THOMAS-NEKTARIOS PAPANASTASIOU, CORRUPTION IN THE INFRASTRUCTURE PROVISION: THE ROLE OF ACCOUNTABILITY MECHANISMS IN THE COMMUNITY DRIVEN DEVELOPMENT PROJECTS OF INDONESIA (2016).

106 *See, e.g.*, Lucinda A. Low, *Coping with the Foreign Corrupt Practices Act: A Primer for Energy and Natural Resource Sectors*, 2(2) CEPMLP INTERNET J. (1997), available at http://www.dundee.ac.uk/cepmlp/journal .

risk that their local representatives will engage in corrupt practices without their knowledge. It is essential in this regard to establish clear internal guidelines and transparent corporate governance structures to reduce the possibility of liability for the company and its owners.

7. Trade Restrictions

1.55 In this book, we deal primarily with risks directly related to investment rather than to trade. As explained earlier, foreign direct investment is subject to a far wider range of serious political risks than either portfolio investment or trade, since most profit-making activities take place within the territorial jurisdiction of the host State. Nevertheless, unexpected new trade restrictions can have a negative impact upon investors as well as upon those who directly trade in the affected goods and services.

1.56 A pertinent example can be found in a dispute, which arose as a result of France's ban on the import of British beef. The restriction was put in place as a response to the "mad cow disease" epidemic in the United Kingdom.[107] The dispute arose when beef that had been cleared for import from Britain into France was denied entry because of the newly-imposed French embargo. The parties to a certain supply contract agreed to ship the beef back to the UK, where it was destroyed by the British authorities. The France-based buyer brought arbitration against the U.K. seller for sums it had already paid for the meat. The tribunal ultimately found against the buyer, largely on the premise that an embargo formed part of the political risk related to the parties' contract. The arbitrators reasoned that because political risk passed to the buyer under the FOB Incoterm applicable to the transaction, the buyer was to bear the consequences of France's decision to impose unforeseen trade barriers.

1.57 We find the inverse fact situation in the NAFTA case of *S.D. Myers v. Canada*. In *Myers*, a U.S. company established an enterprise in Canada to process locally-produced PCB, a form of toxic waste, in its Michigan purification facility. In part to support a domestic PCB-processing industry, the Canadian government banned the export of these waste products to the United States. This measure did significant harm to Myers' Canadian business, although it was still able to engage in other waste processing activities in Canada. While the NAFTA tribunal declined to find that Canada had expropriated Myers' investment, it nevertheless held the State liable for discriminatory and unfair and inequitable conduct towards the American investor, since the trade barrier was clearly disproportionate to any legitimate ecological goal, and was designed in part to shut foreign businesses out of the local market.[108]

1.58 These two awards remind foreign investors that even if the host State provides a stable domestic regulatory framework for the production of goods, the investment may still be vulnerable to trade barriers, if the enterprise depends upon imported components or exported final products. Furthermore, the risk of trade barriers is less predictable than some of the other political risks, because trade is a two-way street: an embargo can be imposed either by the host State or by some other government. Investors may therefore be obliged to undertake political

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107 YEARBOOK OF COMMERCIAL ARBITRATION, vol. XXVI 18–23 (A.J. van den Berg, ed., 2001).
108 *S.D. Myers Corp. v. Canada*, Partial Award of Nov. 13, 2000, 40 I.L.M. 1408 (2001).

risk analysis encompassing certain important countries other than the host country, States upon which the investment will rely for inputs or end markets.

1.59 The international legal system does provide important tools for assessing the risk of trade restrictions. A great number of States are members of the World Trade Organization (WTO), which evolved out of the Bretton Woods/GATT structures of the post-World War II period.[109] WTO members are subject to uniform and stabilized trade practices, negotiated on a multilateral basis.[110] States that violate WTO standards may be subject to inter-governmental arbitration and retaliatory sanctions. Within certain free trade areas, such as NAFTA and the European Union, trade barriers are completely eliminated, and structures are in place to compel payment of compensation directly.[111] Under the WTO/GATT, some trade restrictions are permissible under treaty exceptions, however. In particular, measures with discriminatory impact are allowed to stand if they are necessary to protect national security[112]or the health and safety of humans and animals.[113]

1.60 There are therefore at least three conditions that make the risk of trade restrictions rather difficult for foreign investors to assess and control. First, in most circumstances trade remains outside the scope of most investment treaties, and therefore investors cannot normally invoke dispute resolution provisions directly to obtain redress against an offending host State for unfair or excessive trade barriers. Rather, they must petition their home governments for "espousal" of their claims, either on a purely diplomatic level or before state-to-state dispute resolution bodies such as the WTO. Espousal of claims often depends as much upon the political influence of the petitioner as upon the legal merits of his case. Second, as noted above, any legal claim against a State for compensation may be blocked because most free trade agreements permit a range of "necessary" measures. Finally, trade by its nature involves more than one country, and therefore the investor who relies upon either import or export must simultaneously take into account trade conditions in a range of States.

D. Measuring Political Risk

1.61 In this section, we discuss factors that investors should consider when measuring political risk in a particular State prior to investing. As already noted, we do not address in detail the investment climate of any particular State, as any such attempt would inevitably fall short of the advice of experienced local counsel and specialized political risk services familiar with a particular country.[114] In any event, investment environments and their accompanying political

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109 For an overview of WTO jurisprudence, *see* ANDREAS LOWENFELD, INTERNATIONAL ECONOMIC LAW 21–297 (2003).

110 The WTO has 164 members as of August 20, 2018. Understanding the WTO: The Organization: Members and Observers, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

111 For a thorough account of NAFTA and E.U. trade law in the context of global commerce *see* THE EU, THE WTO AND THE NAFTA: TOWARDS A COMMON LAW OF INTERNATIONAL TRADE? (Joseph H.H. Weiler, ed., 2000).

112 General Agreement on Tariffs and Trade (GATT), available at http://www.wto.org, art. XXI.

113 *Id.*, art. XX.

114 For a useful overview political risk measurement services and techniques, see Claude B. Erb et al., *Political Risk, Financial Risk and Economic Risk*, 52:6 FINANCIAL ANALYSTS J. 28 (November/December 1996), available at http://www.duke.edu/~charvey/Country_risk/pol/pol.htm

risk often change very quickly. Here we provide some overarching guidelines that an investor may follow when analyzing political risk in a developing country.[115]

1.62 Prior to investing in a foreign country, an investor should carefully assess all the risks associated with the investment, including political risks.[116] A complete analysis of political risk requires consideration of a number of factors.

1.63 First, investors should consider the legal structure of the host State. The investor should look for "a well-developed legal and regulatory framework, including favorable tax and labor codes, investment laws, property laws, the protection of intellectual property rights, and competition policy, as well as relative industrial deregulation."[117] Lacunae in important areas provide an opportunity for special interests within the host society to change or interpret existing rules in their favor. An independent judiciary that has developed substantial jurisprudence in administrative, procurement, and State contracts law can provide a very effective damper on political risk.

1.64 Also in this context, the investor should carefully examine local laws governing foreign investment.[118] Many recent investment codes enacted in developing and transition economies provide important assurances covering foreign direct investment. Azerbaijan's foreign investment law permits the free establishment of foreign joint ventures and subsidiaries and provides tax incentives and unrestricted repatriation of profits for foreign businesses.[119] Tanzania's investment code likewise provides for full compensation in the event of expropriation, and establishes mandatory settlement of investment disputes through international arbitration:

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115 On investors' tendency to cyclically overestimate and underestimate political risk, *see* Claire A. Hill, *How Investors React to Political Risk*, 8 DUKE J. COMP. & INT'L L. 283, 306 (1998).

116 While the apprehension of political risk in many parts of the world is certainly justified, investors may in fact over-estimate dangers somewhat, in an abundance of caution. In a study in which executives were asked whether they had removed assets from foreign countries on the basis of a corporate decision (due to poor performance, weak management, or lack of resources) or due to coercive State action, the latter accounted for 5.4% of divestment from 1951 to 1975, and 3.7% from 1967 to 1971. F.N. Burton & Hisashi Inoue, *Expropriations of Foreign-Owned Firms in Developing Countries: A Cross-National Analysis*, 18 J. WORLDTRADE L. 396, 397 (1984). The direct expropriation of the property of United States nationals in developing countries from 1964 to 1974 has been estimated at a mere 1.6% of the total value of U.S. FDI. *Id.* at 397–8.

117 Malcolm D. Rowat, *Multilateral Approaches to Improving the Investment Climate in Developing Countries: The Cases of ICSID and MIGA*, 33 HARV. INT'L L.J. 104 (1992); *see also* Michael A. Geist, *Toward a General Agreement on the Regulation of Foreign Direct Investment*, 26 LAW & POL'Y INT'L BUS. 673, 686–706 (1995) (discussing the foreign investment codes of several nations). On structural risk in Argentina, which is responsible for the country's cyclical economic history, *see* PETER B. KENEN, THE INTERNATIONAL FINANCIAL ARCHITECTURE 13–19 (2001) (explaining the need for evaluating whether capital inflows in an economy are sustainable or temporary). *See also* Grant Nulle, *IMF ignores causes of crisis*, FINANCIAL TIMES, August 18, 2003 at 10.

118 *See* JESWALD SALACUSE, THE THREE LAWS OF INTERNATIONAL INVESTMENT. NATIONAL, CONTRACTUAL, AND INTERNATIONAL FRAMEWORKS FOR FOREIGN CAPITAL, Chapter 6: National Regulation of Foreign Investment (2013).

119 *See generally* COMMERCE, THE OFFICIAL NEWSLETTER OF THE C.I.S.-AMERICAN CHAMBER OF COMMERCE (Fall 1995).

1. 28.— (1) No approved enterprise, or any property belonging to any person shall be compulsorily taken possession of, and no interest in a right over such enterprise or property shall be compulsorily acquired except for public interest and after due process of the law. (2) Where an enterprise is compulsorily acquired, full and fair compensation as provided under Article 24 of the Constitution shall be payable. (3) Any compensation payable under the provision of this section shall be made promptly and shall be transferable.

2. 29.— (1) Where any dispute arises between a foreign investor and the Government in respect of any approved enterprise, all effort shall be made through mutual discussions to reach an amicable settlement. (2) Any dispute between the foreign investor and the Government in respect of an approved enterprise which is not amicably settled through mutual discussions may be submitted to arbitration: (a) in accordance with the rules and procedure for arbitration of the International Centre for the Settlement of Investment Disputes; or (b) 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; or, (c) in accordance with any other international machinery for the settlement of investment dispute agreed by the parties.[120]

1.65 However, foreign investors should be wary of taking such liberal investment codes at face value. It is equally important to know how such codes have been interpreted and implemented by host states. Further, if these local guarantees lack direct investor-State arbitration provisions, in practice they retain the status of local law, since they can only be enforced in local courts. The host State may therefore avoid application of the law's substantive protections, either by pressuring the courts or by changing the law.[121] Nevertheless, it is observed that several countries have recently started introducing various investment restrictions and controls.[122]

1.66 The investor should next consider economic, cultural, political, historical, and legal aspects of the host country that may affect political risk. Relevant economic issues include short-term economic stability, including an analysis of inflation rates, price stability, and exchange rates.[123] This exercise may also involve scrutiny of balance of payments and sovereign debt problems.

[120] Tanzanian 1990 National Investment (Promotion and Protection) Act, art. 28–29. Another example of a liberal investment code can be found in Namibia, Foreign Investments Act 1990, 31 I.L.M. 205 (1992). Under the FIA, if a commercial enterprise is expropriated, the state must pay "just compensation for such expropriation without undue delay and in freely convertible currency." *Id.*, §11(2). The standard of "just compensation" set forth in this code potentially does not offer the same protection as "full compensation" which is found in other recent investment codes adopted by developing states.

[121] *See* Chapter 4. *But see Tradex Hellas S.A. v. Albania*, ICSID Case No. ARB/94/2, Decision on Jurisdiction of December 24, 1996 14 ICSID REV.—FOR. INV. L.J. 161 (1999) (internationalizing domestic law under the ICSID rules).

[122] Karl P. Sauvant, *The Regulatory Framework for Investment: Where Are We Headed?*, 15 Research in Global Strategic Management 407-33 (2011).

[123] Rowat, *supra* note 117, at 104.

A weak or unstable economy, in combination with other factors, may increase political risk, as a State in a weakened economic condition may be more likely to resort to expropriation of foreign investment to alleviate political pressures. The investor should also consider the political stability of the host State.[124] This exercise demands not only an understanding of local political structures, such as how officials are elected and appointed and the relative power of the various branches of government, but also familiarity with current political leaders and their policies and philosophies, especially in relation to investment protection, transparency, and sustainable fiscal policy. An analysis of the State's history regarding respect for the property of foreign investors is useful as well. An investor considering a power project in Iran or Mexico has reason to be cautious, considering the history of economic interference of these states.[125] States that have a history of protecting property rights, on the other hand, are generally less likely, other things being equal, to confiscate foreign investments in the future.

1.67 Finally, treaties on the protection and promotion of foreign investment between the host state and the investor's home state can be very important for an accurate political risk analysis. The most widespread investment treaties, discussed in detail in Chapters 6 and 7, are bilateral investment treaties, known as BITs. These international instruments spread quickly in the 1990s and 2000s, and today there are over 3.324 treaties worldwide.[126] This network is complemented by regional agreements such as the North American Free Trade Agreement (NAFTA), the ASEAN Treaty, and the Energy Charter Treaty. These investment treaties represent an undertaking by signatory States that they will provide predictable conditions and an even playing field to qualifying foreign investors and investments, including repatriation of profits, compensation for expropriation, fair and equitable treatment, and full protection and security. The violation of these standards of treatment trigger the private investor's direct right of international arbitration against the host State.[127] Where a potential investment locale is subject to an applicable investment treaty, the foreign investor can enjoy greater confidence that unreasonable government interference with his activities will be minimized. States are less likely to engage in unpredictable and detrimental conduct if their actions could violate the specific terms of a treaty, rather than the rather amorphous dictates of customary international law.

1.68 But the existence of an applicable investment treaty cannot eliminate political risk.[128] Ultimately, States are sovereign within their territory, and are free to take whatever action they

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[124] Investment trends indicate that investors are more likely to invest in states in which there are assurances that the legal and political systems are unlikely to undergo radical changes. Geist, *supra* note 117, at 686.

[125] Regarding Mexico, *see generally* BAKLANOFF, *supra* note 40.

[126] UNCTAD, WORLD INVESTMENT REPORT – INVESTMENT AND THE DIGITAL ECONOMY 111 (2017), available at http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf .

[127] *See generally* Andreas Lowenfeld, *Investment Agreements and International Law*, 42 COLUM. J. TRANSNAT'. L. 123 (2003); Chapters 6 and 7.

[128] Indeed, a World Bank report suggests that investors take for granted the limited power of investment treaties to deter State action detrimental to their interests. *See* M. Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit—and They Could Bite*, WORLD BANK POLICY RESEARCH WORKING PAPER NO. 3121 (2003), available at http://www.econ.worldbank.org/files/29143_wps3121.pdf.

deem necessary.[129] Investment treaties may compel governments to pay compensation to foreign investors as a consequence of regulatory or other action, but there is no international police force or global government that can restrict the State's freedom to act. Nor is full compensation a "sure thing." As will become clear in Chapter 6, treaty-based investment protection is still novel, and the outcome of any particular arbitration proceeding can be difficult to predict. As a result, while investors should take into account the applicability of international agreements, their primary concerns should be to assess the gravity of political risk in a given jurisdiction, and to avoid investment disputes whenever possible.[130]

1.69 An investor should normally seek advice on various aspects of political risk from competent local legal counsel and economic consultants who have first-hand experience in the State in which investment is being considered. Many multinational companies also retain in-house political risk managers.[131]

1.70 In addition to such advice, the investor may consider using a political risk service. Political risk service-providers are organizations that specialize in providing investors with up-to-date information regarding political (and other) risk, primarily in developing countries. One such service is the Economist Intelligence Unit's Country Risk Service.[132] This service provides risk analysis, including political risk, for over one hundred countries. They produce a report for each country quarterly.[133]

1.71 The Economist Intelligence Unit also produces a quarterly comparison of the countries covered by the Country Risk Service, assigning each state an overall grade of A through E and a more detailed rating of 1 through 100. There are also other significant political risk and related services.[134]

1.72 In addition, the economic and political sections of many countries' foreign missions prepare periodic reports on local investment climate in countries where their nationals are economically

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129 Legislative or parliamentary sovereignty is discussed in further detail in Chapter 4, Section B.1.

130 For a discussion of practical steps that an investor can take to reduce the impact of expropriation on its assets, see Philip Stansbury, *Planning Against Expropriation*, 24 INT'L LAW. 677 (1990).

131 S. Linn Williams, *Political and Other Risk Insurance: OPIC, MIGA, Eximbank and Other Providers*, 5 PACE INT'L. L. REV. 59, 63 (1993).

132 The Economist Intelligence Unit, Country Reports, available at http://http://www.eiu.com; *see also* The Economist Intelligence Unit, Country Risk Service, available at http://http://www.eiu.com.

133 Each report typically includes: credit risk ratings reflecting a country's short-term foreign exchange risks, medium-term lending risks, and political and policy risks; analysis and forecasts of the state of government finances, economic growth, and domestic financial indicators (money supply, interest rates, inflation, and exchange rates; two year projections of the country's external finances, including the current account, external borrowings, and debt-service payments; an analysis of the form and sources of international finance flows (foreign direct investment, bond issues, portfolio investment, and commercial and official lending); and short term trade risk analysis based on the evaluation of the overall financial position of the country as well as foreign exchange reserves.

134 Such services include those offered by: The PRS Group, http://www.prsonline.com; Control Risks Group, http://www.crg.com; Global Risk Assessments, Inc., http://www.grai.com; and Business Environment Risk Intelligence, http://www.beri.com.

active. These assessments can be particularly useful to foreign investors, since the diplomats who provide them are often well-connected in the host Country and enjoy a kind of access to decision-makers that is denied to most private business people.

1.73 While political risk services are a valuable source of information in measuring political risk, these services are best used in conjunction with other methods of determining political risk, such as the advice of experienced local counsel and other counsel familiar with political risk issues.