



MANAGING POLITICAL RISK: CONTRACTUAL STRATEGIES

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- Political instability
- Economic instability
- Nationalisation
- Expropriation
- Creeping Expropriation
- Sanctions

- Joint Ventures
- Investment Agreements
- Loan Agreements
- Acquisitions

1. Risk factors and extractive industries

- Capital intensive
- High up front costs
- Requires several years to become economically viable
- Zones of political risk

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2. Foreign investors need...

- Some certainty as to scope of financial obligations (project sponsors)
- Some assurances as to repayment (project lenders)

To those ends they seek inter alia

- legal risk mitigation tools which address political, legal and regulatory risk
- specifically measures to address extent to which new laws and regulations adopted after the execution of the investment agreement may affect the rights and obligations of the foreign investor under the investment agreement

3. Nationalisation

Can nationalise if:

- non-discriminatory
- public purpose
- procedural safeguards observed
- compensation

NAFTA Article 1110(1)

Energy Charter Treaty 13(1)

4. "Substantial Deprivation" (expropriation)

When:

"Investor will not be able to use, enjoy or dispose of the property"

Pope & Talbot v The Government of Canada UNCITRAL (NAFTA)

Award on the Merits Phase 2 April 10, 2001, para 181

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Determination whether:

- Investor is in control of investment
- Government management of project company
- Government interferes with the payment of the project
- Investor retains full ownership and control of the investment

African examples

Angola	September 2011 new mining code. Government entitled to minimum ownership interest of 10% in operator or minerals extracted
Botswana	October 2011. Government required De Beers to relocate certain staff to Gaborone in exchange for renegotiating period of Diamond Sales Agreement
Guinea	September 2011 new mining code grants Government right to own up to 35% of the share capital of mining companies in Guinea
South Africa	South African's Mineral and Petroleum Resources Development Act 2002 requires certain percentages of mining companies equity to be held by various groups
Zambia	Government announced plans to increase country's interest in mining projects from 20 to 35%

South American and Asian examples

Argentina	Government orders repatriation of expat revenues of energy and mining contracts
Brazil	New mining code seeks to limit licences to various companies and increase royalty rates
Indonesia	Caps foreign ownership of certain mines at 49%; forced reduction in foreign ownership; 20% tax on expats of unprocessed metals
Mongolia	Attempt to renegotiate OT contact to increase ownership from 34% to 50%; also change royalty scale
Peru	Increased taxes on mining activities

6. Revere Copper v OPIC (1978)

"Under international law **the commitments made in favour of foreign nationals are binding** notwithstanding the Power of Parliament and other government organs under the domestic constitution to override or nullify such commitments"

Revere Copper & Brass Inc v Overseas Private Investment Corporation (OPIC), Award August 24 1978, 56 ILR 257

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7. Article 46 of Vienna Convention and the Law of Treaties

"a state may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent **unless that violation was manifest** and concerned a **rule of its internal law of fundamental importance**"

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8. **Texaco v The Government of the Libyan Arab Republic (1977)**

"the recognition by international law of the right to nationalise is not sufficient ground to empower a state to disregard its commitments, **because the same law also recognises the power of state to commit itself internationally**, especially by accepting the inclusion of **stabilisation** clauses in a contract entered into with a foreign private party"

Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic, Award 53ILR 389 (Jan 19 1977)

"Contract language which freezes the provisions of a national system of law chosen as the law of the contract as of the date of the contract, in order to prevent the application to the contract of any future alterations of this system"

(Bishop 1998)

- Risk Mitigation Tool – political, regulatory and Legal Risk
 - a stabilisation clause addresses extent to which new laws and regulations adopted after the execution of the agreement
 - are to be treated and/or
 - how they may affect the rights and obligations of the foreign investor under the agreement

10. Stabilisation clause example

Libyan Concession with Texaco BP and Liamco, cl. 16 provides that:

"The Government of Libya will take all steps necessary to ensure that the Company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties."

11. Stabilisation Clause Types

- Freezing clauses
- Economic Equilibrium clauses
- Hybrid clauses



12. Standard Form Freezing Clause

The Government hereby undertakes and affirms that at no time shall the rights (and the full and peaceful enjoyment thereof) granted by it under this Agreement be derogated from or otherwise prejudiced by any Law or by the action or inaction of the Government, or any official thereof, or any other Person whose action or inactions are subject to the control of the Government. In particular, any modifications that **could be made in the future to the Law as an effect on the Effective Date shall not apply to the Concessionaire and its Associates without their prior written consent**, but the Concessionaire and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date.

In the event of any conflict between this Agreement or the rights, obligations and duties of a Party under this Agreement, and any other Law, including administrative rules and procedures and matters relating to procedure, and applicable international law, **then this Agreement shall govern the rights, obligations and duties of the Parties.**

13. Togolese Petroleum Concession Contract 1977

Article 30:

- "30.3: The parties hereto further agree that during the entire validity of this Agreement **no provisions hereof shall be amended, supplemented or replaced**, except by mutual agreement between them, confirmed in writing and signed by their lawful representatives.
- 30.4: **This Agreement prevails over the existing or future legislation of either a general or special nature**, except in the cases where it is otherwise provided for herein, and the Republic guarantees that no special or general law will be enacted and no other action whatsoever will be taken by it to the effect of amending, supplementing or terminating this Agreement, except as otherwise expressly provided for this Agreement."

13a. Chad-Cameroon Oil Development and Pipeline Project

Article 24(1) of the COTCO-Cameroon agreement provides that:

"With regard to activities undertaken under this Convention, the **Republic of Cameroon shall not modify such legal, tax, customs and exchange control regime in such** a way as to adversely affect the **rights and obligations of** COTCO, Shareholders, Affiliates, Contractors, Sub-Contractors, Shippers or Lenders arising from this Convention and no legislative, regulatory or administrative measure contrary to the provisions of this Convention shall apply to the persons mentioned above without COTCO's prior written consent".

13b. Chad-Cameroon Oil Development and Pipeline Project (continued)

Article 21(3) of the TOTCO-Chad agreement provides that:

"During the term of this Convention, the **Republic of Chad** guarantees **that no governmental act taken after December 19, 1988 will be applied to TOTCO, without prior agreement between the Parties**, which has the duly established effect of increasing, directly, indirectly or by virtue of its application to Shareholders, the obligations and charges imposed by this Convention or which has the effect of adversely affecting the rights and economic benefits of TOTCO or of Shareholders as provided for in this Convention, including the effect duly established and passed on to TOTCO of the adverse effect on the charges of Affiliates or of the Contractors as a result of such act."

13c. Latin American Infrastructure Model Agreement (Freeze)

The State guarantees the Investors and the Recipient Company that this Investment Contract, the Project Agreements and the State Institution Authorisations, in each case in relation to the Investments and the Project, shall enjoy absolute legal stability in accordance with the Legal Framework in Effect. **Accordingly, neither the Investment Contract, nor the Project Agreements nor the State Institution Authorisations may be modified unilaterally by laws or other dispositions from the State** of any type that affect them or by changes in the interpretation or application thereof and each thereof in which the State is a party may only be modified by the mutual written agreement of the Parties that expressly evidences such modifications.

13d. Limited Freezing Clause model example

The....Laws and Decrees which may in the future impose higher rates or more progressive rates of [tax] or would otherwise impose a greater....tax liability than that anticipated under Section....of the Upstream Project Agreement shall not apply to the Company.

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Early Cases

- *Lena Goldfields -v- USSR (1930)*

Pursuant to Article 76 the Soviet government promised to make no alteration to the agreement by order, decree, or other unilateral act, or at all except with Lena's consent

- *Sapphire International Petroleum Ltd -v- National Iranian Oil Company (1967)*

Article 38 "*no general or special statutory enactment, no administrative measure or decree of any kind, made either by the government or by any governmental authority in Iran.....can cancel the agreement or affect or change its provisions, or prevent or hinder its performance. no cancellation, amendment or modification can take place except with the agreement of the two parties*".

Libyan Nationalisation cases

- *BP Exploration Company (Libya) Ltd -v- Government of the Libyan Arab Republic (1978)*
- *Texaco Overseas Oil Petroleum Co/Californian Arabic Oil Co. -v- Government of the Libyan Arab Republic (1979)*
- *Libyan American Oil Company -v- Government of the Libyan Arab Republic (1977)*

"The Government of Libya will take all steps necessary to ensure that the Company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties. This concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of execution of the agreement of amendment by which this paragraph 2 was incorporated into this concession agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent."

14. The Mittal Liberian Investment Agreement

Article xix section 9:

"Any modifications that could be made in the future to the Law as in effect on the Effective Date shall not apply to the CONCESSIONAIRE and its Associates without their prior written consent, but the CONCESSIONAIRE and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date. **In the event of any conflict between this Agreement or the rights, obligations and duties of a Party under this Agreement, and any other Law, including administrative rules and procedures and matters relating to procedure, and applicable international law, then this Agreement shall govern the rights, obligations and duties of the Parties."**

15. "Mittal accused of creating a state within a state in Liberia" - The Guardian 3 October 2006

"A damning report on Mittal Steel's acquisition of an impoverished African Country's iron ore reserves is published today, accusing the world's largest steelmaker of offering an inequitable "raw deal" that has created an unaccountable "state within a state"...

But the report says: "It is hard to believe that in signing the agreement the national transitional government was acting in the best interests of the nation, and Mittal has taken full advantage of this"...

Erosion of sovereignty: The contract includes a stabilization clause – often used to give protection to a company's investment – which Mittal says is necessary for a 25 year deal. But the report says the agreement goes too far, allowing Mittal to pick and choose with which new laws it will comply. Liberia's right to regulate in the area of human rights, international obligations and the environment could be undermined..."

16. Economic Equilibrium Clause

In the event of the occurrence of a Change in Law (including a Change in Law that becomes applicable to the Company because of damage to and the restoration of the Plant) that requires a material modification or a material capital addition to the plant, which is completed by the Company, or in lieu thereof or in addition thereto, an increase or decrease in operating costs including the use or quality of fuel or consumables by the plant, and this Agreement is not terminated by....pursuant to Article....., the Company will be entitled to receive Recovery Allowance payments under...from...to recover fully the costs of complying with the Change in Law, including the costs of any material modifications or material capital additions to the Plant that are necessary for the Company to come into compliance with the Change in Law. The amount of any Recovery Allowance due under this Article shall be determined pursuant to Article....

17. The Baku-Tbilisi-Ceyhan Pipeline

"The State Authorities shall take all actions available to them to restore the Economic Equilibrium established under the Project Agreements if and to the extent the Economic Equilibrium is disrupted or negatively affected, directly or indirectly, as a result of any change (whether the change is specific to the Project or of general application) in Azerbaijan Law (**including any Azerbaijan Laws regarding Taxes, health, safety and the environment**) occurring after the later of (1) the Effective Date or (2) the date that the Government has fulfilled its obligations under Section 7.1 or 7.2(i), as applicable, including changes resulting from the amendment, repeal, withdrawal, termination or expiration of Azerbaijan Law, the enactment, promulgation or issuance of Azerbaijan Law, the interpretation or application of Azerbaijan Law (whether by the courts, the executive or legislative authorities, or administrative or regulatory bodies), the decisions, policies or other similar actions of judicial bodies, tribunals and courts, the State Authorities, jurisdictional alterations, and the failure or refusal of judicial bodies, tribunals and courts, and/or the State Authorities to take action, exercise authority or enforce Azerbaijan Law (a "Change in Law"). The foregoing obligation to take all actions available to restore the Economic Equilibrium shall include the obligation to take all appropriate measures to resolve promptly by whatever means may be necessary, including by way of exemption, legislation, decree and/or other authoritative acts, any conflict or anomaly between any Project Agreement and such Azerbaijan Law"

18. Limited indemnification clause

- Indemnification against a specified act of law
- Requirement that Investors must comply without compensation with environmental, human rights and health and safety laws
- Mitigation requirement
- Requirement that indemnification may only be triggered if costs exceed a minimum amount

19. Drafting Stabilisation Clauses Suggestions

- Economic equilibrium not freeze
- Limited not full
- No indemnification re human rights, health & safety and environment
- Establish compensation threshold

20. Bilateral Investment Treaties

- No expropriation
- Fair and equitable treatment
- Full protection and security
- Non discrimination
- National treatment
- Most favoured nation treatment
- Comply with obligations
- Standard of compensation
- Investor can bring a claim in International Arbitration

- Expropriation
- Currency restrictions
- Violence and war
- Contract frustration or breach of contract

Coverage narrower than BIT but can be tailored

Issues of:

- (i) market capacity
- (ii) coverage and
- (iii) enforcement

Definition:

- "**Material Adverse Effect**" means [in the reasonable opinion of the Majority Lenders] a material adverse effect on:
 - a) the business, operations, property, condition (financial or otherwise) or prospects of the Group taken as a whole;
 - b) [the ability of an Obligor to perform [its obligations under the Finance Documents]/[its payment obligations under the Finance Documents and/or its obligations under [clause [20.2] (Financial condition)] of this Agreement]]/[the ability of the Obligors (taken as a whole) to perform [their obligations under the Finance Documents]/[their payment obligation under the Finance Documents and/or their obligation under [clause [20.2] (Financial condition)] of this Agreement]]; or
 - c) the validity or enforceability of the Finance Documents or the rights or remedies of any Finance Party under the Finance Documents.

Representation:

There has been no material adverse change in its business or financial condition (or the business or consolidated financial condition of the Group, in the case of the Company) since [XXXX]

Event of Default:

Each of the events or circumstances set out in clause 22 is an Event of Default (save for clause 22.22 (Acceleration)).

Material adverse change

Any event or circumstance occurs which the Majority Lenders reasonably believe has or is reasonably likely to have a Material Adverse Effect.

11.1 Illegality

If it becomes unlawful in any applicable jurisdiction for a Lender to perform any of its obligations as contemplated by this Agreement or to fund, issue or maintain its participation in any Utilisation [or it becomes unlawful for any Affiliate of a Lender for that Lender to do so]:

- a) that Lender, shall promptly notify the Agent upon becoming aware of that event;
- b) upon the Agent notifying the Parent, each Available Commitment of that Lender will be immediately cancelled; and
- c) to the extent that the Lender's participation has not been transferred pursuant to clause 41.7 (Replacement of Lender), each Borrower shall repay that Lender's participation in the Utilisations made to that Borrower on the last day of the Interest Period for each Utilisation occurring after the Agent has notified the Parent or, if earlier, the date specified by the Lender in the notice delivered to the Agent (being no earlier than the last day of any applicable grace period permitted by law) and that Lender's corresponding Commitment(s) shall be cancelled in the amount of the participations repaid.

A3 – Sanctions Reps and Undertakings in Loan Agreement (Example)

SPECIFIC DEFINITIONS

- **"Restricted Person"** means a person that is (i) listed on, or owned or controlled by a person listed on any Sanctions List; (ii) located in, incorporated under the laws of, or owned or controlled by, or acting on behalf of, a person located in or organised under the laws of a country or territory that is the target of country-wide Sanctions; or (iii) otherwise a target of Sanctions.
- **"Sanctions"** means any economic sanctions laws, regulations, embargoes [Local applicable Sanctions] or restrictive measures administered, enacted or enforced by: (i) the United States government; (ii) the United Nations; (iii) the European Union; (iv) the United Kingdom; or (v) the respective governmental institutions and agencies of any of the foregoing, including without limitation, the Office of Foreign Assets Control of the US Department of Treasury ("**OFAC**"), the United States Department of State, and Her Majesty's Treasury (together "**Sanctions Authorities**")
- **"Sanctions List"** means the "Specially Designated Nationals and Blocked Persons" list issued by OFAC, the Consolidated List of Financial Sanctions Targets issued by Her Majesty's Treasury, or any similar list issued or maintained or made public by any of the Sanctions Authorities.

A3 – Sanctions Reps and Undertakings in Loan Agreement (Example)

UNDERTAKINGS

The undertakings in this clause [XXX] remain in force from the date of this Agreement for as long as any amount is outstanding under the Finance Documents or any Commitment is in force:

- a) each Obligor undertakes that it, and will procure that any other member of the Group, or any director, officer, agent, employee or person acting on behalf of the foregoing, is not a Restricted Person and does not act directly or indirectly on behalf of a Restricted Person.
- b) each Obligor shall, and shall procure that each other member of the Group shall, not use any revenue or benefit derived from any activity or dealing with a Restricted Person to be used in discharging any obligation due or owing to the Bank;
- c) each Obligor shall, and shall procure that each other member of the Group shall, to the extent permitted by law promptly upon becoming aware of them supply to the Agent/Bank details of any claim, action, suit, proceedings or investigation against it with respect to Sanctions by any Sanctions Authority.

Use of proceeds

- d) each Obligor shall not and shall procure that any other member of the Group shall not, permit or authorise any other person to, directly or indirectly, use, lend, make payments of, contribute or otherwise make available, all or any part of the proceeds of the Facility or other transactions contemplated by this Agreement to fund any trade, business or other activities: (i) involving or for the benefit of any Restricted Person, or (ii) in any other manner that could result in any Obligor or the Bank being in breach of any Sanctions or becoming a Restricted Person.

Compliance with laws

- e) each Obligor shall comply in all respects with all laws to which it may be subject, if (except as regards Sanctions, to which clause [u](f) applies) failure so to comply would materially impair its ability to perform its obligations under the Facility Agreement; and
- f) each Obligor shall, and shall procure that each other member of the Group shall, comply in all respect with all Sanctions.

A3 – Sanctions Reps and Undertakings in Loan Agreement (Example)

REPRESENTATIONS

No Obligor, nor any of its Subsidiaries or directors, is either:

- a) listed, or is owned or controlled, directly or indirectly, by any person which is on a Sanctions List or is a Restricted Person;**
- b) located, organised or resident in a country which is the subject of Sanctions;**
- c) a governmental agency, authority, or body or state-owned enterprise of any country which is the subject of Sanctions;**
- d) no Obligor nor any of its subsidiaries has at any time entered into transactions with any Restricted Person; or**
- e) is in breach of any anti-money laundering laws.**



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