

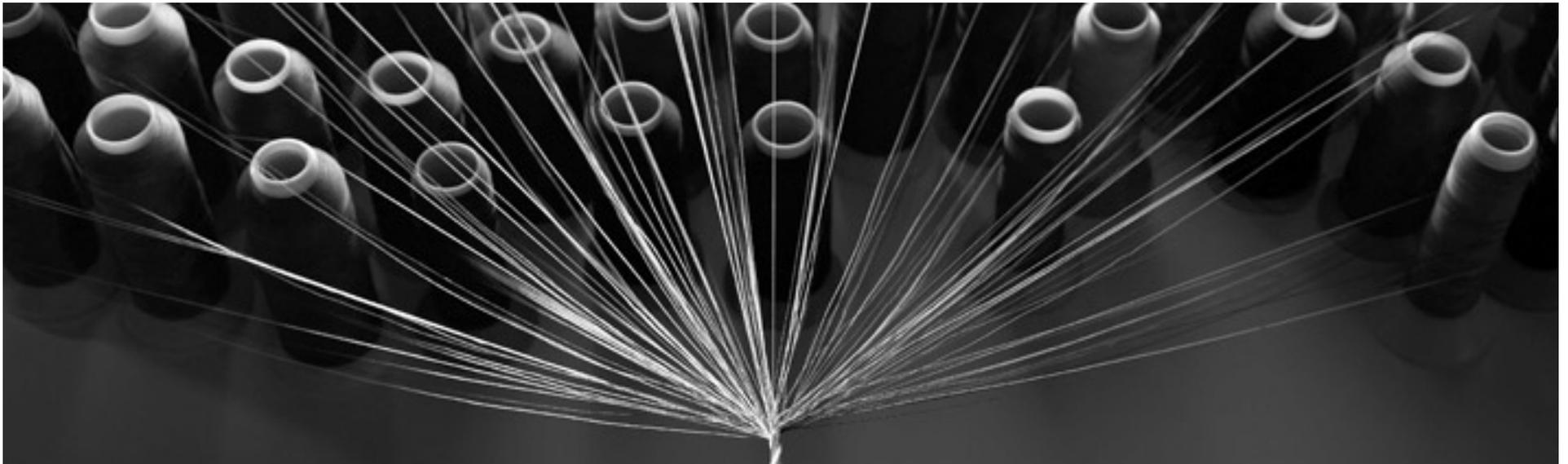
Managing Political Risk in Latin America

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Introduction to Trends in Latin America

- Investment in a foreign State usually involves large sums of money, takes long periods of time, involves several parties and deals with political issues. Investment in Latin America is no exception.
- Foreign investors doing business in Latin America are no strangers to:
 - Commercial/Market Risks; and
 - Political Risks
 - Instability risks (e.g. coups, wars, rioting)
 - Government risks (*i.e.* those risks that arise out of deliberate government action)

Some Recent Examples of Political Risk

- **Legal and Regulatory Interference**

- Nationalization or direct expropriation
- Increase or imposition of new taxes
- Imposition of reinvestment requirements
- Limitations to currency convertibility/transferability

- **Confiscation or Nationalization of Movable Assets**

- Confiscation or nationalization of valuable operating assets, supplies and/or materials
- Denial of re-exports permits and licenses

- **Contract Breach**

- Non-payment of overdue invoices
- Failure to comply with other economic obligations
- Refusal to comply with dispute resolution mechanisms

Some Recent Examples of Political Risk

- **Contract Repudiation** (on the grounds that:)
 - The contract was procured through corruption
 - The contract is contrary to the national public interest
 - The contract was awarded in violation of constitutional or legal norms

- **Forced Contract Renegotiation**
 - Unilateral amendments to key economic terms
 - Repudiation or termination of the contract
 - Exclusion from future contracts
 - Nationalization
 - Other forms of coercion

Some Recent Examples of Political Risk

- **Restrictions on Access to International Arbitration**

- Explicit waiver of right to international arbitration
- Threats to cancel contracts or to exclude from future contracts oil service contractors resorting to arbitration
- Refusal to incorporate commercial arbitration clauses in new contracts
- Termination of Bilateral Investment Treaties (BITs)
- Denunciation of the ICSID Convention
- Withdrawal of consent to ICSID jurisdiction for certain disputes (Article 25(4) of the ICSID Convention)
- Restrictive interpretation of national investment laws

Contractual Mechanisms for Risk Minimization

- **Stabilization Clause?**

- A stabilization clause may freeze applicable law or contract terms. The use of stabilization clauses is a direct response to unilateral actions of host governments that alter the conditions to foreign companies under previously concluded long term agreements.

- **Adaptation Clause**

- Triggered when a change of circumstances causes a substantial modification of the economic equilibrium of the contract or change of law.

- **Protection against Non-Payment**

- Consider standby letters of credit, escrows, advance payments, right to suspend the contract.

Contractual Mechanisms for Risk Minimization

- **Automatic Compensation**

- Pre-ante stipulation of monetary remedies that are appropriate in the event that the host state unilaterally changes key economic terms of the contract through its regulatory power.

- **Early Termination Fee**

- Unqualified obligation to compensate the oil service contractor in the event of early termination or cancellation of the contract as a result of state action.
- Penalty Clause vs. Liquidated Damages.

Contractual Mechanisms for Risk Minimization

- **The Force Majeure Clause**

- Must be carefully drafted to anticipate what happens when a government act prevents performance or compliance under an oil service contract with the government -controlled national oil company.

- **The Arbitration Clause**

- Limitations and restrictions on the inclusion of arbitration clauses in state contracts of national public interest.
- For instance, Article 151 of the Venezuelan Constitution restricts, in principle, the arbitrability of disputes involving “contracts of public interest.”
- Contract claims vs. Treaty claims

Practical Mechanisms for Risk Minimization

- **Seeking Strategic Partners**
 - *The state may be more reluctant to expropriate or breach a contract entered into with a national of a country with which the host state has close economic or political ties.*
- **Involving multi-lateral agencies**
 - *The state may be more reluctant to nationalize movable assets or property in which an agency (e.g. the International Finance Corporation) or a foreign government has a stake.*

Practical Mechanisms for Risk Minimization

- **Political risk insurance (PRI)**
 - *PRI is aimed at guaranteeing compensation to the insured investor for a loss of all or part of its investment.*
 - *Main Providers:*
 - *The Multilateral Investment Guarantee Agency (MIGA)*
 - *The Inter-American Development Bank (IADB)*
 - *National Insurance Agencies such as the Overseas Private Investment Corporation (OPIC)*
 - *The rise of resource nationalism has made PRI premiums prohibitively expensive in certain countries.*

Investment Treaty Planning

- **Nationality**
- Structuring an investment so as to take advantage of the protections afforded by one or more BITs entails satisfying the formal requirements of nationality under the specific BIT language:
 - Incorporation
 - Actual Control vs. Legal Capacity to Control (*Aguas del Tunari*)
 - Origin of Capital Irrelevant? (*Tokios Tokeles*)
- **Treatment Standards**
- **Treaty Shopping?**

Investment Treaty Arbitration

- **ICSID**

- Most frequently used arbitration centre for the settlement of investment disputes in the World.
- ICSID Awards are directly enforceable in the municipal courts of all States parties to the ICSID Convention.

- **ICSID's Additional Facility**

- Arbitration under the Additional Facility is available when:
 - The host State is not a party to the ICSID Convention, or
 - The State of nationality of the investor is not a party to the Convention.
- Additional Facility Awards are enforceable through the New York Convention.
- Is Additional Facility available for States who have denounced the ICSID Convention?
Treaty Language

- **Ad-hoc Arbitration under the UNCITRAL Rules**

- No administering Centre.
- Enforcement under the New York Convention.
- Special Agreement sometimes necessary.

Investment Treaty Arbitration

- **Denunciation of the ICSID Convention; a Latin American trend?**
 - **Bolivia (2007)**
 - **Ecuador (2009)**
 - **Venezuela (2012)**
 - **Nicaragua (?)**
 - **Argentina (?)**
- **ALBA Members have announced their intention to create their own investment dispute settlement centre.**

Conclusions

- **What lessons, if any, can be learned from the recent political risk trends in Latin America?**
- States can and will revise contracts unilaterally as they become increasingly more sophisticated at using national law to their benefit.
- In spite of political risk, opportunities in Latin America remain highly attractive.
- Investors would be well advised to address the complex interaction between state sovereignty and investors' property and contractual rights, as well as the multiple layers of risk involved (particularly arising out of domestic law) in order to maximize investment protection in the host state.
- Investment Treaty Planning is key when investing in Latin America.
- Investors should pay due regard to the arbitration alternatives offered by each of the Investment Treaties available.

Thank you for your attention

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