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LDC Infrastructure Development in the Era of 'Nationalistic Rhetoric': Do International Investments Agreements Still Mitigate Sovereign Risk and If Not, Does It Matter?[1]

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Abstract

Less Developed Countries (LDCs) provide enormous opportunities for companies involved in the development of infrastructure. LDCs couple significant need with often insufficient 'in country' capability or expertise, meaning that foreign companies willing to expand operations into LDCs can find interesting and profitable opportunities. International infrastructure development naturally brings with it the sovereign risks associated with contracting with the government of a LDC. During the last thirty years, governments of LDCs have actively sought the execution of International Investment Agreements (IIAs) with other nations in an attempt to mitigate the appearance of sovereign risk and encourage greater international investment. This has included encouraging foreign companies in the delivery of infrastructure projects.

In the last five years, however, worldwide political support for IIAs seems to be waning, as nationalism and populism threatens to replace globalism and multiculturalism as the dominant economic and political theories in the USA, Europe and Great Britain. In a global political landscape dominated by nationalistic rhetoric, we are unlikely to see continued popular support for the protection of foreign companies against national interests by way of IIAs. We are likely to see not only fewer new IIAs, but conceivably governments revoking their agreement to existing IIAs coupled with waning support for ICSID arbitrations. The author submits, however, that there will not necessarily be a marked increase in sovereign risk as a direct result, and that LDCs will continue to provide worthwhile markets and opportunities for infrastructure development.

The author submits that IIAs never in any event provided complete protection, and that protection against sovereign risk remains available through the underlying contract and in many cases, through political risk insurance. Further, international participants should look at projects with shorter timeframes to secure the return on investment, and avoiding taking sole risk on project by operating in joint ventures.

Keywords: expropriation, sovereign risk, restitution, LDCs, BITs, International Investment Agreements

1. Introduction

1.1 The Infrastructure Deficit and Globalisation of the Construction Industry

Large scale infrastructure investment is desperately needed in most Less Developed Countries (LDCs). This need spans a range of industries, including oil and gas, natural resources, telecommunications, transport and power.[2] Infrastructure investment has historically failed to keep pace with demand and as a consequence, there is a significant, and increasing infrastructure deficit.[3] This deficit is most pronounced in LDCs.[4] Whilst there is

[1] An earlier draft of this article was submitted as part of coursework undertaken for the LLM at Melbourne Law School, University of Melbourne

[2] Philip Fletcher P and Andrew Pendleton, 'International Project Finance' in Julio Cesar Bueno (Ed.), *The Projects and Construction Review* (Law Business Research, 2011) 1.

[3] The World Bank, *Brief: Global Infrastructure Facility* (8 October 2014) < http://www.worldbank.org/en/topic/publicprivatepartnerships/brief/global-infrastructure-facility> accessed on 14 November 2017

[4] G20 Development Working Group Policy Paper, *'Infrastructure needs in developing countries,'* at page 2,

demand for infrastructure in LDCs, there is often a lack of 'in country' expertise to design, construct, and manage or operate complex infrastructure, and there is also often a lack of sufficient funds from domestic budgets to finance the required infrastructure investments[5]. This has created opportunities for 'international contractors' willing to expand their operations into LDCs and willing to undertake longer term, concession based 'investments projects' or PPPs in LDCs[6].

The contemporary opportunities for international contractors to deliver infrastructure projects in LDCs arose somewhat concurrently with, and arguably as a result of, 'globalisation' and the drive for open trade boarders and international commerce. The opportunities also coincided with the increasing mobility and 'internationalisation' of contractors, which enabled contractors to diversify their sources of work, and to take their skills and capabilities to new markets, and the international mobility of equity and debt looking for profitable projects on which to be deployed. 'Globalisation' opened the door for foreign contractors and investors to move into LDCs to invest in, and develop, infrastructure assets.

1.2 Sovereign Risk and the Era of International Investment Agreements

Notwithstanding globalisation and the willingness of international contractors and investors to participate in projects in LDCs, sovereign risk remained a significant issue and a hurdle for some LDCs in encouraging foreign participation. Where contractors and investors were willing to participate, significant projected returns were required to justify the assumed risk. The wave of expropriations of the 1960s to mid 1970s[7] obviously affected the subsequent willingness of international investors and contractors to assume risk and exposure to LDCs and LDC governments were forced to consider what steps could be taken to encourage foreign direct investment. It was around this time, that International Investment Agreements (primarily in the form of Bilateral Investment Treaties) first came to be considered and executed between capital importing nations and capital exporting nations. The negotiation and execution of IIAs was initially slow, but developed from a trickle to a flood from the 1990s onwards[8]. IIAs set up protocols and rules intended to protect foreign investors that entered the markets of other nations that were signatories to a relevant IIA, and make 'investments' in those nations.[9] These IIAs appeared to establish reliable foundations for foreign investors from treaty countries to enter developing markets of treaty counterpart nations, but the protections were in many circumstances imperfect and, it is submitted in this paper, could also in many cases be provided by way of direct contract between the investor, international contractor and the host government procuring the infrastructure asset or granting the concession for the development of the infrastructure asset[10]. The protections of IIA could historically have been agreed by way of direct contract meaning that, subject to the negotiated terms that could be achieved, IIAs were not essential. If, as already appears to be the case[11], there is a future broad based rejection (or retraction) of IIAs or dispute resolution before the International Centre for the Settlement of Investment Disputes (ICSID) in the new era of nationalism, those protections extended to investors in IIA could instead become creatures of contract, between the LDC governments granting the specific infrastructure concession and the international participants financing, developing, owning and operating the asset.

IIAs purport to create protections for international investors by extending a number of guarantees from the host

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< http://www.g20dwg.org/documents/pdf/view/14/ > accessed on 19 January 2018

[5] Amar Bhattacharya, Mattia Romani and Nicholas Stern, 'Infrastructure for development: Meeting the challenge,' Policy Paper June 2012, Centre for Climate Change Economics and Policy, Grantham Research Institute on Climate Change and the Environment, in collaboration with Intergovernmental Group of Twenty Four, at page 5

[6] The World Bank, "*Spending More and Better: Essential to tackling the infrastructure gap,"* < http://www.worldbank.org/en/news/feature/2016/04/16/spending-more-and-better-essential-to-tackling-the-infrastructure-gap > accessed on 7 January 2017

[7] Stephen Kobrin, "Expropriation as an attempt to control foreign firms in LDCs: Trends from 1960-1979", *International Studies Quarterly,* 3 (September): 329-48,

[8] As of 1989, 385 BITs had been concluded, whereas by the end of 2006, 2,573 BITs had been signed (UNCTAD, *Investor-State Dispute Settlement and Impact on Investment Rulemaking: The Asia Pacific Perspective* (2007) < http://unctad.org/en/docs/iteiia20073_en.pdf>.

[9] Ibid.

[10] Jason Webb Yackee, '*Pacta Sunt Servanda* and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality' (2008) Volume 32, Issue 5, *Fordham International Law Journal*, 1550 at 1552

[11] See, for example, Sergey Ripinski, '*Venezuela's withdrawal from ISCID: What it does and does not achieve,'* International Institute for Sustainable Development, 13 April 20132, < https://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/ > accessed on 19 January 2018 and Sergey Ripinski, '*Venezuela's withdrawal from ISCID: What it does and does not achieve,'* International Institute for Sustainable Development, 13 April 20132, < https://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/ > accessed on 19 January 2018

state with respect to the investment landscape, thereby theoretically minimising the foreign investors' exposure to political perils in the host country[12]. These guarantees typically include, among other things, preclusion against expropriation unless certain criteria were satisfied, as well as 'fair and equitable treatment,' and access to independent, enforceable dispute resolution by way of ICSID arbitration. It is commonly accepted that the provisions governing expropriation and the right to compensation, and access to ICSID arbitration are the most important provisions in IIAs.

Notwithstanding the proliferation of IIAs over the last 25 years, and the general preclusion against uncompensated expropriation stipulated within IIAs, risk of expropriation still existed for foreign participants delivering projects of 'national significance' in developing nations,[13] particularly in politically unstable nations, and in new democracies[14]. It is argued, however, that the risks of expropriation exists irrespective of the existence or otherwise of an IIA and that in many cases, the remedies available to an international investor under an IIA could simply be included within the terms of the underlying contract or concession agreement. Whether with or without the protection of an IIA, an investor holding a contract with the host state, containing a provision for international arbitration by a neutral arbitral tribunal, under reliable arbitral rules and supervised by a recognised institution, recognising the inviolable rights of each contracting party to the benefits contained in and provided for by the contract and including a waiver of sovereign immunity, will typically enjoy similar rights of dispute resolution and similar remedies to an investor pursuing ICSID arbitration against a host state under an IIA.[15]

1.3 The Imperfect Protection of IIAs

IIAs certainly provide some protection to foreign investors,[16] however IIAs do not completely safeguard a party's interests nor, as is noted above, are they the only way that an international investor or contractor can access independent dispute resolution, an enforceable arbitral award, or rights of protection of an investment or contractual commitments. An IIA would mandate a course of conduct and provide a forum for independent dispute resolution (as could in any event be included in the underlying contract), but the existence of an IIA does not guarantee that a host state will not still seize the underlying asset and breach its obligations under an IIA (the same way it may elect to breach a contract). The foreign investor would be able to arbitrate against the host state for a breach of the IIA (or the underlying contract, if it provided for arbitration), the arbitral award may nonetheless be insufficient to fully compensate the foreign participant for all of the losses suffered, including compensation on account of the risks assumed in contracting for the project, the 'opportunity cost' of being unable to allocate their resources to a more successful or profitable project, the reputational damage of being terminated and expelled from a project and the management time invested in negotiating the issues and managing the departure from the project and/or the country.[17] Additionally, a foreign investor or contractor will often face potential enforcement risk, whether holding an award from an ICSID arbitration or from any other arbitral tribunal. This is particularly problematic against smaller or poorer nations, which may not have assets of significant value outside of their own jurisdiction (whether a signatory to the New York Convention or not) and which may be willing to face the consequences from the international community in refusing to recognise an ICSID or other international arbitration award. In such a case, a foreign investor may not only receive a smaller award which is insufficient to compensate for its total loss, but it may also have limited options other than to seek enforcement of such award in the local courts of the expropriating state. This may not provide a viable enforcement avenue, if the independence and integrity of the local courts is not guaranteed.[18]

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[12] Robert Ginsburg, 'Political Risk Insurance and Bilateral Investment Treaties: Making the Connetion' (2013) 14 *The Journal of World Investment & Trade* 943-977, 948.

[13] Manabu Nose, 'Triggers of Contract Breach: Contract Design, Shocks or Institutions?' (Policy Research Working Paper 6738, World Bank, January 2014) 5, 6 < http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/01/06/000158349_20140106093814/Rendered/PDF/WPS6738.pdf >.

[14] Ibid

[15] Above, n 11

[16] Although it should be noted that the more recent IIAs with newly industrialised countries or developing countries do not always align with the models favoured by the EU and the US. See Federation of German Industry, Department for External Economic Policy, Position Paper, *Protecting European Investment Abroad: A Roadmap for Improved International Agreements* (March 2014), 7.

[17] *Kuwait v American Independent Oil Company (Aminoil Award),* 24 March 1982, 21 *International Legal Materials* (1982) 976, 1034.

[18] Federation of German Industry, Department for External Economic Policy, Position Paper, *Protecting European Investment Abroad: A Roadmap for Improved International Agreements* (March 2014), 4.

1.4 The New Era of Nationalism and the Move away from IIAs

In the new era of nationalism, where the governments and populations of major developed nations are openly discussing closed door trade policies, and are actively challenging the wisdom and ongoing maintenance of FTAs and foreign investor protections, international investors now face a whole new realm of risks. Will governments revoke their consent to FTAs and IIA? Will there be a new wave of nations moving away from treaty commitments, and refusing to negotiate or enter into new IIAs? And if so, will this be a major problem for international investors seeking infrastructure projects in LDCs?

The IIA regimes never provided a 'silver bullet' to resolve jurisdictional risks for international participants, but during the era of globalism, there was an inter-dependence that supported the IIA network and maximised the likelihood of host governments respecting IIAs and ICSID arbitral awards. In the new era when global superpowers are eschewing globalism and international commerce, and are actively reducing foreign aid budgets[19], it seems less likely that governments of LDCs, facing pressure from their populations or from opposition political parties in unstable democracies, will be minded to give effect to the terms of an IIA or to submit to and respect an ICSID Award. The value and protection of IIAs developed not solely from the terms of the IIA itself, but also from the global commitment to international trade and commerce. If a host state was to encourage trade and commerce with other nations, and was to expect fair and equitable treatment for its domiciled companies conducting commerce in other states, there was a willingness to participate and play by the rules - an international *quid pro quo*. If LDC governments do not expect to be beneficiaries of international trade or commerce and sense that the major global economic powerhouses are looking to trade domestically rather than internationally, and if LDCs also determine that they are less likely to be beneficiaries of foreign aid, the supporting network around the IIA structures will lose its force and the practical protection and benefits of IIAs will also erode.

1.5 The Alternatives to Protection under IIAs

If, as it seems, IIAs may prove less popular during the new era and may provide less genuine protection to foreign contractors and investors delivering infrastructure in LDCs, as nationalism and protectionism replaces globalisation and international interdependence, does that mean that international businesses should turn their backs on investment and infrastructure development opportunities in LDCs? No, because the volume of available opportunities is significant, but it does mean that international investors and contractors must recognise, identify and manage the risks, and accept that IIA protection is likely to be less reliable than it previously was. Alternatives such as ensuring analogous rights and protections are contained within the underlying contractual terms, faster investment return timeframes, and reduced exposure (by taking smaller value projects or operating in joint ventures), as well as ensuring adequate political risks insurance is held on high risk projects, may be more suitable ways to access major infrastructure projects in LDCs, given the new era of nationalism and its impact on the reliability of IIAs.

2. The Scope for International Involvement in LDC Infrastructure Projects

2.1 The LDC Infrastructure Deficit, PPPs and the Risk of Expropriation

An extra 2 billion people are expected to relocate to LDC urban centres by 2030[20] and it is estimated that an additional USD 1 trillion to 1.5 trillion in infrastructure investment is required in low and middle-income countries during the next 10 years to meet the infrastructure demand. It is clear that there is, and will continue to be, a significant volume of construction projects and investments available in LDCs, providing foreign parties with the opportunity to expand operations, build a more diversified and potentially profitable business, and ameliorate the risks of a slowdown in construction work in their home jurisdictions.[21]

Although 'traditional' procurement remains the primary method of infrastructure delivery in the developing world, the extent of required investment and the global political shift in favour of privatisation has led developing nations to consider alterative forms of infrastructure delivery and financing.[22] Currently around 20%

[19] Molli Ferrarello, '*What "America First" means for US foreign aid,"* 27 July 2017 at < https://www.brookings.edu/blog/brookings-now/2017/07/27/what-america-first-means-for-us-foreign-aid/ > accessed on 22 January 2018

[20] The World Bank, above n 4

[21] Sachin Kerur and William Marshall, 'Identifying and managing risk in international construction projects' (2012) 1 *International Review of Law,* 8

[22] Michael Trebilcock and Michael Rosenstock*, Infrastructure PPPs in the developing world: Lessons from recent experience* (19 March 2013), Institute for International Law and Justice, New York University School of Law <http://www.iilj.org/newsandevents/documents/trebilcock.pdf>

of developing world infrastructure is delivered through PPP,[23] but it is reasonably to expect that percentage to increase if the infrastructure deficit is to be addressed.[24]

It is likely that a stream of infrastructure PPPs or concession based projects in LDCs will be available to international contractors and investors who can bring debt financing to the transaction and who have an appetite to assume the risks of foreign projects. The greatest consequence risk for foreign participants is, of course, the expropriation of their investment by the host state. The likelihood of an expropriation occurring increases over time, so a longer period concession project has a statistically higher likelihood of being expropriated than a shorter term traditionally procured construction project or contract.[25] Accordingly, PPP or concession based projects with 20 to 30 year terms are more susceptible to expropriation than traditionally procured projects.[26] Given the reasonable expectations of a significant stream of construction projects becoming available in LDCs over the next decade and the likelihood that a greater percentage of these projects will be concession agreement based, direct and indirect expropriation will continue to be a major potential risk to be faced by foreign contractors and investors. If the protections against expropriation contained within IIAs cannot be relied upon and accepted to be constant for the next 20 or 30 years, it is critical that contractors and investors accepting projects of this nature take other steps when entering into concession agreements to protect their rights, without relying on IIAs.

3. The Rise of International Investment Agreements

3.1 The history of IIAs

The first bilateral investment treaty was signed in 1959 between Germany and Pakistan, and since then, there have been over 2,700 BITs signed by 179 countries.[27] This explosion of BITs and other IIAs arose as a result of expropriation policies adopted by a number of developing nations during the 1960s and 70s, and the resulting recognition by both host states and foreign investors of the need to restore a climate favourable to international investment. The primary mechanism that has been pursued to restore such a climate has been the development of a set of commitments regarding the protection of international investments,[28] and the incorporation of such commitments into bilateral and multilateral investment treaties agreed between nations.

The process of negotiating and agreeing an investment treaty in itself imposes a moral obligation on a host state, and its government, to comply with the obligations contained therein. Further, the consequences of investment treaty breach can be significant, both in respect of the remedies which may flow to the international party on the specific project and in respect of the international reputational damage suffered by the host state.

In light of those issues, and the 'lessons learned' from the expropriation policies of the 1960s and 70s, it has been argued by a number of scholars that the 'old problem' of direct expropriation has now subsided[29], and that the contemporary issue to be addressed by IIAs is the resolution of non-discriminatory actions taken by States which are in the public interest but detrimental to the foreign investment (i.e. 'indirect' expropriation).[30]

3.2 LDC Participation in the Global Economy as a Precondition to the 'death' of Expropriation

The basis for the argument that direct expropriation is a thing of the past, is that states will not spoil their records of stability by engaging in nationalisations, particularly given the need for foreign investment and the inadequacy of national budgets to supply this required infrastructure, the recent history of international trade and commerce driving investment in LDCs and advancement for the citizens of LDCs,[31] and the need for continued foreign aid to LDCs.

This argument assumes, however, that LDC governments will maintain the opinion that they will continue to

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[23] Ibid 12.

[24] World Bank Group and PPIAF, "*The State of PPPs – Infrastructure Public-Private Partnerships in emerging markets and developing economies, 1991 - 2015",* June 2016, at page 6, < *https://ppiaf.org/documents/3551/download* > accessed 7 January 2018

[25] Ginsburg, above n 13, 948.

[26] Ibid.

[27] International Institute for Sustainable Development, *50th anniversary of the first bilateral investment treaty: an occasion for celebration or reflection?* (3 December 2009), < https://www.iisd.org/media/press.aspx?id=13>.

[28] Professor Patrick Julliard, 'Bilateral Investment Treaties in the context of investment law' (Speech delivered at the Investment Compact Regional Roundtable on Bilateral Investment Treaties for the Protection and Promotion of Foreign Investment in South East Europe, Dubrovnik, Croatia, 28 May 2001).

[29] See, for example, Julliard above n 29.

[30] Julliard, above n 29.

[31] Muthucumaraswamy Sornarajah, *The International Law of Foreign Investments* (Cambridge University Press, 2nd Ed, 2005), 435.

benefit from international trade and commerce, from inflows of foreign capital, and from aid from other nations so as to ensure their willingness to remain compliant members of the international community. The argument assumes that LDCs will continue to participate in the 'global economy' and that globalisation will continue as the driving economic and political theory. If capital exporting nations, and nations that are bringing investment and capabilities to LDCs, including North America, Europe, and the UK, are demonstrating a move away from globalisation, are reducing foreign aid budgets and are driving policies of nationalism and protectionism, the 'repeat transactions' motivation that has driven the behaviours of LDCs may cease to have the same power. If at the same time, changes in underlying policies within LDCs gives rise to hostility to foreign investment, a perfect storm could develop and manifest in renewed willingness to consider nationalising[32] or expropriating assets and a refusal to continue to participate in or respect IIAs.

The academic assertion regarding the death of direct expropriation ignores the genuine risk of expropriation (whether direct or indirect) of 'vulnerable' projects, being projects which are nationally significant or politically charged and also ignores the change in global political discourse, from internationalism and expansionism to nationalism and protectionism. It also fails to recognise the resurgence of direct expropriation, particularly in the airports sector, during the last 20 years.

4. The Contemporary Renaissance of Direct Expropriation and the Risk to 'Vulnerable' Projects

4.1 'Reports of My Death Have Been Greatly Exaggerated'[33] - the Ongoing Risk of Expropriation

Notwithstanding the optimism regarding the end of direct expropriation,[34] the socio-cultural, political and economic phenomena that give rise to direct expropriation are impossible to predict particularly over the long time horizons often involved with major infrastructure investment.[35] Accordingly, the assumption of the death of direct expropriation is premature in circumstances where LDC infrastructure projects are likely to be increasingly delivered under longer term, concession based projects and are likely to be subject to increased political risks over the project term.

Risks vary according to the infrastructure activity and ownership structure. Investments that supply the public directly, such as power and water, toll roads and airports, are more visible and more likely to attract political attention than wholesale activities where there is minimal interaction between the foreign participant and the local community. Foreign involvement and public awareness increases the likelihood of political attention and hence the risk of adverse government action.[36] Natural resource projects are also vulnerable to direct expropriation and political interference, given public fear of loss of sovereignty and loss of control over exhaustible resources.[37] Given the infrastructure deficit and the necessity to prioritise asset delivery in LDCs, it is reasonable to assume that direct supply infrastructure projects such as power and water and transport projects and income producing natural resources projects will dominate the medium term procurement landscape.

The arguments advanced in the academic literature to support the death of direct expropriation ignores the significant but regionally diverse recent history of direct expropriation of concession based airports projects. Over the last fifteen years, a significant number of long term, concession based airport projects in the developing world have been expropriated by host governments, frequently as a result of regime change within the host state.

4.2 A Snapshot of Contemporary Expropriations

In 2001, the Hungarian Government expropriated Budapest International Airport, and deprived the Cypriot/Canadian investors of their rights to operate the airport and earn profit following the completed construction and renovation of the terminals. In 2005, the government of the Venezuelan state of Nueva Esoarta took back control of an airport on the island of Margarita, and cancelled a concession agreement granted to a JV between the Swiss company Flughagen Zurich AG and its Chilean partner, Gestion e Ingeneria IDC SA to expand and run the airport. Also in 2005, the Philippines Government expropriated Manila airport and terminated a concession agreement granted to the consortium involving the Germany company, Fraport, on the

[32] Ibid.

[33] With apologies to Mark Twain

[34] Warrick Smith, 'Covering Political and Regulatory Risks: Issues and Options for Private Infrastructure Arrangements' in Timothy Irwin, Michael Klein, Guillermo E. Perry and Mateen Thobani (eds), *Dealing with Public Risk in Private Infrastructure* (The World Bank, 1997) 45, 47.

[35] Ibid.

[36] Ibid.

[37] Thedore Moran, *Foreign Direct Investment and Development* (Institute for International Economics, 1999), 141.

basis that the airport belonged to the people.[38] In 2007, the Governor of the Miranda state of Venezuala, expropriated Caracas Airport for public use. In 2012, the Maldivian Government expropriated Male' International Airport and repudiated the 25 year concession agreement, following an effective coup in the country.[39] In 2013, the Bolivian government nationalized an airport operator owned and run by the Spanish company, Abertis, responsible for the operations of airports at La Paz, Santa Cruz and Cochabamba.[40]

4.3 Vulnerable Projects and the Risk of Direct Expropriation

Vulnerable projects remain as susceptible to direct expropriation as they ever have. Airports fall within the category of a vulnerable project as they are often highly profitable and provide a large range of revenue streams to the operator, demand reasonably low capital and operational expenditure (subject to the extent of runway or terminal construction activities that are often required as part of the granting of a concession agreement over an airport), often do not require highly specialised operational expertise (excluding air traffic control), and are often politicized as a 'gateway' for the citizens of the country that ought to be owned and operated for and by the country. In that sense, they can be used as a political platform for xenophobic rhetoric and to galvanise the public support for regime change[41]. It is of course not only airports projects that are highly profitable and can be seen as national 'trophy assets' that are vulnerable to political rhetoric as a platform for regime change and subsequent expropriation, but the airports sector provides a useful illustration that direct expropriation remains a live risk for international investors and contractors.

There is no doubt that direct expropriation carries with it significant financial consequence, reputational damage and overall detriment to the host nation, and that such action is rarely efficient over the longer term or objectively beneficial. An assumption of decisions based on efficiency and objective benefit however presupposes an inherently stable political landscape and a long term, non-reactionary government. It also assumes 'repeat transactions,' and a benefit for LDCs from ongoing participation in the 'global economy.' If the promises of the 1990s and 2000s of repeat international transactions and participation of LDCs in the global economy has become a whisper, and major trading nations are looking inwards rather than outwards, the 'penalties' of direct expropriation may be less severe and pronounced that they may previously have been.

5. The Recognised Basic Right of a Host State to Expropriate and the Standard Criteria for 'Legal' Expropriation under Iias and International Law

5.1 The Right of States to Expropriate and the Obligation for Compensation

The protection of private property has been recognised in international law for around a century, initially under the Hull formula, which required 'prompt, adequate and effective compensation'[42] in the event of the expropriation of a private right. The concept developed from the protection and treatment of aliens,[43] with it being accepted that 'acts of a government in depriving an alien of his property without compensation impose international responsibility.'[44] Such protection is not, however, unlimited and governments retain general rights to legislate and undertake such other acts as the government may deem necessary for the public good. Accordingly, while the rights of a foreign investor or contractor delivering an infrastructure project typically enjoy some protection under domestic and international law, host states retain overall sovereign rights.

Customary international law recognises the right of a host state to expropriate foreign investments,[45] provided

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[38] Airport World, *Philippine Court orders Manila terminal compensation,* (25 May 2011), < http://www.airport-world.com/news/general-news/638-philippine-court-orders-manila-terminal-compensation.html>.

[39] Amy Kazmin, *Maldives takes airport from consortium,* (7 December 2012) Financial Times < http://www.ft.com/intl/cms/s/0/9ab24628-4061-11e2-8e04-00144feabdc0.html#axzz3WEgOsBfY>.

[40] BBC, *Bolivia nationalizes three Spanish owned airports,* (18 February 2013), BBC < http://www.bbc.com/news/world-latin-america-21499296>.

[41] See, for example, Minivan News article, 10 November 2012 *"Adhaalah Party head gives government six day ultimatium to renege on GMR airport deal"* Minivan News, https://minivannewsarchive.com/politics/adhaalah-party-head-gives-government-six-days-to-renege-on-gmr-airport-deal-47068 accessed on 21 January 2018

[42] The 'Hull formula' for compensation being adopted from a diplomatic note of the US Secretary of State, Cordell Hull to his Mexican counterpart in 1917, cited by August Reinisch, 'Legality of Expropriations,' in August Reinisch (ed), *Standards of Investment Protection* (Oxford University Press 2008), 195

[43] August Reinisch, 'Legality of Expropriations,' in August Reinisch (ed), *Standards of Investment Protection* (Oxford University Press 2008), 173.

[44] *De Sabla Claim (US v Panama),* Award, 29 June 1933, 6 UNRIAA 358, 366.

[45] OECD, *'Indirect Expropriation and the Right to Regulate in International Investment Law,'* (September 2004) < http://www.oecd.org/daf/inv/investment-policy/WP-2004_4.pdf>.

that certain conditions are met. The right to expropriate and the necessary conditions for legal expropriation are also typically stated in IIAs[46] and in many domestic legal systems.[47] Typically under IIAs, those conditions are:

(a) the taking of the investment must be for a public purpose,

(b) it must be subject to due process or as provided by law (to the extent relevant),

(c) it must be undertaken in a non-discriminatory manner, and

(d) compensation must be paid.[48]

By way of example, the BIT signed by Australia and Egypt[49] in 2001 provides that:

> *"Neither Party shall nationalise, expropriate or subject to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as 'expropriation') the investments of investors of the other Party, unless the following conditions are complied with:*
>
> *(a) the expropriation is in the public interest which is related to the internal needs of that Party and under due process of law;*
>
> *(b) the expropriation is non-discriminatory; and*
>
> *(c) the expropriation is accompanied by the payment of prompt, adequate and effective compensation."*

The first ever BIT, signed between Germany and Pakistan in 1959, contained a similar provision addressing the mandatory process to be followed for a legal expropriation in accordance with the terms of the BIT, and such protections are a common theme of BITs and MITs.

Accordingly, where an expropriation occurs on a project the subject of an IIA, the expropriation can be deemed either 'legal' or 'illegal,' subject to compliance or otherwise with the IIA. Compliance with the terms of the IIA renders the expropriation 'permissible'[50] but also adversely affects the compensation available to the investor, as discussed further below.

This distinction suggests that in theory, an international investor under the protection of an IIA and suffering an expropriation will either be entitled to, and receive payment of, full compensation in compliance with the provisions of the relevant IIA (as part of a 'permissible' expropriation), or will otherwise have an entitlement under international law and the terms of the IIA to bring a claim for damages for wrongful expropriation and/or termination. The situation in practice can be quite different.

5.2 The Problems for International Investors Facing 'Legal' Expropriation under an IIA

The first problem for international investors is that the 'hurdles' for a host state to 'legally' expropriate are very low, and it is often difficult for the international investor to demonstrate an entitlement to, and receive and award of, adequate damages to fully compensate the international investor. Arbitral tribunals have shown reluctance to challenge a host state's assertion of what constitutes 'public interest' or 'public purpose' from the perspective of the host state, and it is general accepted that satisfying the requirement of public purpose is not a significant hurdle.[51] Similarly, it can be difficult for a foreign investor to demonstrate discrimination in expropriation. Discrimination usually requires the implementation of unreasonably policies or motivations such as racism or political retaliation against nationals of certain states.[52] The difficulty, of course, is that any expropriation – short of a general nationalisation programme – will target specific groups of property owners or investors, whether airport operators, oil exploring companies or highway construction entities.[53] This is because if a single asset is expropriated, that action could be argued to unreasonably target the specific nationality, or category investor due to its individual nature but the fact that there may be only one affected entity is usually not enough to constitute a discriminatory taking.[54] Demonstrating discrimination where a single asset has been expropriated is often quite

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[46] Reinisch, above n 44, 176.

[47] Consider, for example, the *Australian Constitution* s51(xxxi).

[48] OECD, above n 46.

[49] Agreement on the Promotion and Protection of Investments (Australia-Egypt)(5 September 2002) ATS 2002 19.

[50] Reinisch, above n 44, 176.

[51] Sornarajah, above n 32, 395.

[52] Reinisch, above n 44, 190.

[53] Ibid.

[54] Stephan Kinsella and Noah Rubins, *International Investment, Political Risk and Dispute Resolution – A Practitioner's Guide* (Oceania Publications, 2005) 177.

difficult.

With respect to 'due process,' while many IIA's state that due process must be followed, they rarely define its meaning.[55] The due process obligation can be satisfied by expropriating pursuant to domestic law, or otherwise by providing an entitlement to the foreign investor to have the validity of the expropriation, or compensation, assessed by an independent body.[56] Where an IIA applies to an expropriated project, it is conceivable that the 'due process' requirement is satisfied simply by the IIA itself including the right for the foreign investor to refer the correctness of the decision to arbitration, whether ICSID or otherwise, and through the compliance by the expropriating state with its domestic legal requirements, if any. Clearly, the 'due process' threshold is a low one.

The final threshold for establishing a 'legal' expropriation is the payment of compensation. Different tribunals have addressed this obligation in different ways. Some have found that the existence of a procedure to claim and receive an award of compensation is sufficient to render an expropriation lawful notwithstanding that no compensation had been actually paid,[57] whereas other tribunals have held that the making of an offer of compensation at or around the time of expropriation would be sufficient, failing which the action is confiscatory[58] and accordingly illegal. Other tribunals have found that if compensation was not in fact paid at or around the time of the expropriation, the expropriation was unlawful.[59] While the decision on this issue may turn on the relevant provisions of the IIAs,[60] it is apparent that the process to satisfy the compensation requirement for legal expropriation remains unclear. Most worrying for an international investor, is the fact that the existence of a right to have compensation determined by an independent tribunal has previously been considered sufficient to satisfy the compensation threshold. Clearly a remedy of this nature does little to protect an investor, who will be put to the task of arguing their entitlement and quantifying their loss before any compensation is paid, while the investor will likely be required to make immediate repayment of debt obligations to its lenders. The above serves to demonstrate that in practice, the 'protections' against 'illegal' expropriation in IIAs is somewhat illusory.

The incorporation of 'conditions' to be satisfied under IIAs for expropriation to be 'legal' or 'permissible' create a sense of protection for foreign investors. The reality, however, is that the threshold for satisfying the conditions is quite low and it can be difficult for a foreign investor to demonstrate that an expropriation is illegal. Whilst the investor may eventually obtain compensation, likely after a long and costly ICSID arbitral proceeding, in the meantime the investor is forced to discharge its debt obligations and carry the costs and losses suffered from the project and the expropriation. Further, IIAs do not significantly constrain a host nation from expropriating in the first place. From this perspective, IIAs do not offer particularly robust protection for an international investor against expropriation.

6. The Right to Restitution or Restitutionary Damages Including Loss of Profit for 'Illegal' Expropriation

6.1 The Correct Measure of Damages against a State Following Illegal Expropriation

As noted above, there is a reasonably low threshold for a host state to prove that an expropriation was 'legal'. Perhaps the greater problem for an international investor is, however, whether or not it demonstrates that the expropriation was illegal, the measure and quantum of damages to which it will be entitled remains at the discretion of an arbitral tribunal. There remains a high likelihood that an international investor will not receive full compensation, particularly when considering the opportunity cost of having invested in a subsequently aborted project, the reputational damage of being expropriated and the managerial time invested in the dispute, rather than in managing and growing the business.

The primary purpose of demonstrating that an expropriation is illegal, is to obtain access to the remedies that can be sought for an illegal expropriation which are usually in excess of the remedies available for a legal expropriation.

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[55] Reinisch, above n 44, 191.

[56] United Nations Conference on Trade and Development, *Taking of Property,* UNCTAD Series on issues in international investment agreements, 2000, 16 < http://unctad.org/en/docs/psiteiitd15.en.pdf>.

[57] *Amoco International Finance Corp v Iran* (1981) 15 Iran-US CTR, 189.

[58] *British Petroleum v Libya* (Award)(1973) 53 ILR 297, 329 and *LETCO v Liberia* (Award) 2 ICSID Rep 343, 366.

[59] *ADC Affiliate Limited and ADC & ADCM Management Ltd v Hungary (Award)* (ICSID Arbitral Tribunal, Case No ARB/03/16, 2 October 2006) [366].

[60] It is conceded that where an IIA expressly requires payment for expropriation consistent with the *Hull Formula* ('prompt, adequate, and effective,') an 'entitlement' to compensation through the arbitral process or an 'offer' of compensation without payment is unlikely to satisfy the threshold.

The standard 'theoretical' remedy for illegal expropriation is restitution, that is, the re-establishment of the situation which existed before the wrongful act was committed.[61] The seminal case on the entitlement to restitution in the event of illegal expropriation is the *Chorzow Factory* case, in which the Tribunal stated that *"reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear."*[62]

Although the *Chorzow Factory* case is often referred to in support of entitlements to restitution[63], the Permanent Court of International Justice did not in fact award restitution in that case,[64] it being accepted by both parties that restoring the Chorzow Factory was impossible.[65] Rather the Court determined the sum to be awarded to place the dispossessed companies as far as was possible in the same economic situation as if the seizure had not taken place,[66] i.e. restitutionary damages. Not only was restitution not ordered in the *Chorzow Factory* case but prior to 1999, it had rarely been ordered in the 200 years of modern arbitral practice and in the jurisprudence of the international courts.[67]

More recently, restitutionary damages have been awarded for unlawful expropriation, and it remains the case that an international investor will be able to argue for a potentially larger remedy in circumstances of 'illegal' expropriation than 'legal' expropriation, being restitutonary damages. The Tribunal in the case of *ADC v Hungary*[68] applied the *Chorzow Factory* standard, after the Tribunal found that the relevant BIT did not contain any *lex specialis* rules that govern an unlawful expropriation, and accordingly the Tribunal applied the default standard contained in customary international law.[69] A similar approach was taken by the Tribunal in *Siemens v Argentina,*[70] where the Tribunal found that the compensation standard in the Argentina-Germany BIT only applied to expropriation in accordance with the Treaty (i.e. a 'legal' expropriation), otherwise compensation should be based on the principles of customary international law.[71] This approach was also followed in *Vivendi v Argentina,*[72] again holding that the measure of compensation payable under the Argentina-France BIT only applied to lawful expropriation, and did not purport to establish a *lex specialis* governing the standard of compensation for wrongful expropriations.[73] The Tribunal in *Vivendi v Argentina* confirmed that "*it is generally accepted today that, regardless of the type of investment, and regardless of the nature of the illegitimate measure, the level of damages awarded in international investment arbitration is supposed to be sufficient to compensate the affected party fully and to eliminate the consequences of the state action."*[74]

Accordingly, more than eighty years after the *Chorzow Factory* case, the distinction between lawful and unlawful expropriation and the applicability of the customary international law standard of restitutionary compensation have experienced a renaissance.[75] Where restitution is not possible, the remedy of restitutionary damages will theoretically entitle the expropriated international investor to a sum on account of loss of future profits,[76] typically on a discounted cash flow (DCF) basis. Following the application of the international law

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[61] *Responsibility of States for Internationally Wrongful Acts,* Article 35, GA Res 56/83, UN GAOR, 56th session, UN Doc A/56/49(Vol.1)/Corr.4 (12 December 2001).

[62] *Case concerning the factory at Chorzow (Government of Germany v Government of the Polish Republic)(Claim for Indemnity – merits)*[1928] PCIJ (ser A) No 17, 47.

[63] Pierre Bienvenu and Martin Valasek, 'Compensation for Unlawful Expropriation, and Other Recent Manifestations of the Principle of Full Reparation in International Investment Law' in Albert Jan van den Berg (ed), *50 Years of the New York Convention: ICCA International Arbitration Conference* (Dublin 2009), 234.

[64] Christine Grey, 'The Choice between Restitution and Compensation' (1999) 10(2) *European Journal of International Law* 413, 416.

[65] *Case concerning the factory at Chorzow (Germany v Poland)(Merits)* 1928 P.C.I.J. (Ser. A) No.17 (September 1928)

[66] Ibid.

[67] Grey, above n 65.

[68] *ADC Affiliate Limited and ADC & ADCM Management Limited v The Republic of Hungary (Award)* (ICSID Arbitral Tribunal, Case No ARB/03/16, 2 October 2006).

[69] Ibid.

[70] *Siemens A.G v The Argentine Republic (Award)* (ICSID Arbitral Tribunal, Case no ARB/02/8, 17 January 2007).

[71] Ibid, 349.

[72] *Compania de Aguas del Aconquija S.A. and Vivendi Unviversal S.A. v Argentine Republic (Award)*(ICSID Arbitral Tribunal Case No ARB/97/3, 21 November 2000).

[73] Ibid, 243.

[74] Ibid, 244-245.

[75] Bienvenu and Valasek, above n 64, 255.

[76] Derek Bowett, 'State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach' (1988) 59 *British Yearbook of International Law* 49, 63.

standard of damages, an international investor suffering an illegal expropriation will be entitled to reparation, which includes direct losses as well as some quantum for lost earnings or lost profits.[77] Lost earnings or profits will generally not be available to the investor in the event of a legal expropriation.[78] Where a legal expropriation has occurred, the investor is entitled only to compensation equating to the *damnum emergens,* or losses suffered upon the date of expropriation.[79] These losses are typically limited to the static value of the investment's assets, and will very rarely constitute adequate or complete compensation.

On the other hand, if an international investor who has been awarded a 25 year concession for an infrastructure development project can obtain an award including its lost profit in the event of expropriation, the actual risks to the international investor will be significantly reduced. Specifically, the opportunity cost, cost of capital and expenditure of management time will be adequately compensated through the award of the profits to which the international investor would have been entitled during the term of the concession, but for the expropriation.

6.2 The Reluctance of Arbitral Tribunals to Award Full Damages on a Restitutionary Basis Even in the Event of 'Illegal' Expropriation

In addition to the difficulty of proving that an expropriation is 'illegal,' there are two further major hurdles for international investors in seeking awards for loss of profit. First, lost profits being projections of future events, are inherently uncertain.[80] Second, arbitral tribunals have demonstrated reluctance to make significant loss of profit awards where to do so would have a potentially significant, adverse effect on the host state. In this sense, there is a 'respondent friendly' jurisprudence around loss of profits claims.

The uncertainty of establishing or proving lost profit does not necessarily prevent an arbitral tribunal from making such an award,[81] but does lead to a likelihood of significant discounting of claimed profit or a rejection where the asserted lost profit cannot be established with sufficient certainty. This is consistent with the approach in many domestic legal systems.[82] Further, no measure of damages are intended to put the wronged party in a better position than they would have been, were it not for the event giving rise to the damages award. Accordingly, where a concession agreement contains termination rights for the host state, or where the host state could have 'legally' expropriated by following the requirements stated in the relevant IIA, an award of the full value of the foreign investors expected profits over the term of the concession agreement will place the foreign investor in a more favourable position than if the expropriation had not occurred. This is because the loss of profit award will ignore the possibility that the concession agreement may in any event have come to an end prior to its completion, whether through a 'legal' expropriation or through the exercise of a termination provision. Accordingly, in those circumstances, an arbitral tribunal will likely discount the loss of profit remedies to take account of the possibility that the total profit would not have accrued. This concept is also consistent with the approach taken in many domestic legal systems.[83]

With respect to the reluctance of arbitral tribunals to make significant awards against host states, this concept is notionally recognised in the ILC Articles on Responsibility of States for Internationally Wrongful Acts,[84] and may also be an attempt by arbitral tribunals to inject a sense of fairness or equity into damages awards. In the *CME* arbitration, Professor Brownlie noted that the Claimants had claimed USD 495 million against an approximate gross national income of USD 53.9 billion of the host state. In considering the damages entitlement and the operation of the relevant BIT, he noted that "it would be strange indeed, if the outcome of acceptance of a bilateral investment treaty took the form of liabilities 'likely to entail catastrophic repercussions for the livelihood and economic well-being of the popluation' of the Czech Republic."[85] In the *Santa Elena*

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[77] Suzy Nikiema, 'Compensation for Expropriation' (March 2013) *International Institute for Sustainable Development – Best Practice Series* < https://www.iisd.org/publications/best-practice-compensation-expropriation>

[78] Sayyed Khalil Khalilian, 'The Place of Discounted Cash Flow in International Commercial Arbitration: Awards by Iran-United States Claims Tribunal' (1991) 8 *Journal of International Arbitration* 31, 49-50.

[79] Nikiema, above n 78.

[80] Ibid, 333.

[81] Ibid.

[82] Consider, for example, *Automotive Latch Systems Limited v Honeywell International Inc.* [2008] EWHC 217.

[83] Consider, for example, *Golden Strait Corporation v Nippon Yusen Kubishika Kaisha* [2007] UKHL 12.

[84] Article 37(3).

[85] *CME Czech Republic B.V. v The Czech Republic* UNCITRAL, Separate Opinion on the issues of quantum by Ian Brownlie, 14 March 2003.

arbitration,[86] the Tribunal was presented with the Claimant's quantification of loss at USD 6,400,000 compared to USD 1,900,000 as determined by Costa Rica. The Tribunal awarded USD 4,150,000, exactly half way between the positions of the parties. It has been suggested this was an exercise of discretionary pragmatism, to provide an amount that would not 'break' Costa Rica but also would not disappoint the Claimant's expectations to such an extent as to cause it to seek annulment of the Award.[87]

Ultimately, international investors must recognise the hesitancy of investment tribunals to invoke lost profits, or to temper them given circumstances such as general economic malaise. Accordingly, while the theoretical measure of relief is reparation or restitutionary damages including loss of profit, such an award is subject to the discretion of the tribunal and is therefore intrinsically uncertain. Damages awards for 'illegal' expropriations, even if the illegality can be proved, will likely disappoint an international investor and leave the investor with an incomplete remedy for the loss of their asset and the contract.

7. Enforcement Risks

7.1 The Process for ICSID Award Enforcement

Whether or not an IIA/ICSID Tribunal elects to exercise its discretion and make an account for lost profit in its award, the international investor still needs to enforce the award. It is typically assumed that ICSID awards are enforceable within the Contracting States with no possible resistance to enforcement,[88] and that other international arbitral awards are enforceable either through New York Convention[89] recognition (where enforcement was sought in a Convention state), or through the relevant domestic legal systems. The reality, however, can be somewhat different.

An ICSID award is intended to be binding, as if it was a final judgment of a court within that State.[90] However, a number of countries which are signatories to the ICSID Convention, including China, have failed to enact any specific legislation to facilitate the recognition and enforcement of an ICSID award.[91] Accordingly, if an investor was to seek enforcement of an ICSID award in China, it would require a judicial interpretation of the award from the Supreme People's Court. Without such, it is highly doubtful that a PRC Court would enforce an ICSID Award.[92]

Further, the ICSID Convention provides for enforcement as if the award is a final judgment of a court within that State. Accordingly, enforcement will be subject to the domestic laws of the State, which may contain express grounds upon which enforcement of a judgment can be resisted. In any event, the international investor will be subject to the risks and uncertainties inherent in proceeding before the local courts.

Finally, adherence to the ICSID Convention does not waive a States' sovereign immunity in relation to execution.[93] Consent to adjudication or arbitration also does not amount to a waiver of sovereign immunity from execution.[94] Accordingly, unless the underlying concession agreement or construction contract contains a broad and clear waiver of sovereign immunity in respect of enforcement of awards, a foreign investor may face challenges to enforcement on the basis of sovereign immunity.

With respect to enforcement under the New York Convention, perhaps the biggest challenge for an international investor seeking to enforce a significant award against a developing nation is identifying assets of significant value within a New York Convention jurisdiction. Where small sums are identified in different jurisdictions, the international investor may need to undertake simultaneous enforcement proceedings in multiple jurisdictions, and to carry the resulting risks and costs involved with complex enforcement proceedings.

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[86] *Compania del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica (Award)* (ICSID arbitral tribunal, Case No ARB/61/1, 17 February 2000).

[87] Charles Brower and Jarrod Wong, 'General Valuation Principles: The Case of *Santa Elena'* in Todd Weiler (ed), *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May, 2005) 774-775.

[88] Albert Jan van den Berg, 'Some Recent Problems in the Practice of Enforcement under the New York and ICSID Conventions' (1987) 2 *ICSID Review* 439.

[89] The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 10 June 1958.

[90] ICSID Convention, Article 54.

[91] James Barratt and Margarita Michael, 'The 'Automatic' Enforcement of ICSID Awards: The Elephant in the Room?' (2014) 2 *The European, Middle Eastern and African Arbitration Review.*

[92] Julian Ku, 'The Enforcement of ICDIS Awards in the People's Republic of China' (2013) 6 [1] *Contemporary Asian Arbitration Journal* 31.

[93] Above n 91, Article 55.

[94] Hazel Fox, *The Law of State Immunity,* (Oxford University Press, 2nd ed, 2010) 602.

The above analysis has sought to identify that although IIAs became the *de rigur* avenue through which LDCs sought to encourage FDI and were one of the main sovereign risk mitigation strategies relied upon by international investors, in practice they do not on their own provide the kind of protections to international investors that they are often assumed to provide.

8. The New Era of Nationalism, the Move away from Economic Globalism and the Reductions in Foreign Aid Spending

8.1 IIAs in an Era of Global Interdependence Compared to the 'New Normal'

IIAs have never done enough to fully protect international investors delivering ‘vulnerable’ projects in LDCs, however they previously provide a useful framework for the protection of rights and were supported by a wider structure of economic globalisation, interdependent, repeat transactions and foreign aid support. This web of transactions and relations meant that governments of LDCs had a lot to lose if they were to expropriate a project and to refuse to compensate the foreign investor, or if they were to refuse to recognise and satisfy an ICSID arbitral award.

Following Brexit, the growth of nationalism in continental Europe, and the rhetoric of the Trump administration with respect to NAFTA and general protectionism[95], it is strongly arguable that the web of transactions and relations that previously supported IIAs and made it more likely that they would be complied with, is not what it once was. The goodwill between trading nations and the assumption that LDCs would enjoy benefits from positive relationships with other nations that may invest in infrastructure development in the LDC, is likely to be weaker and less reliable and may be less effective in supporting the concept of interdependence in IIAs, so as to thereby drive compliant conduct. LDC governments facing strong domestic political pressure, may find there is more to gain than to lose from opportunistic expropriation in a new era of nationalism.

The risk to BITs and ICSID arbitration can be illustrated by the denouncement of the ICSID Convention by Bolivia, Ecuador and Venezuela in 2012,[96] and the conceptual rejection of international investment dispute settlement by nations that have suffered at the hands of such forums. President Trump's repeated rhetoric signalling a disruptive change to US trade relations,[97] opposing NAFTA, and his demands for renegotiation also undermine the sense of global support for international trade and interdependence. The lingering questions arising from the imminent exit of England from European common market, including how England and Europe will trade and the potential implementation of tariffs also send a strong message to the rest of the world that there is no longer the same 'open doors' trade policy as dominated international relations in the 1990s and 200s.

9. Beyond IIAs – Sovereign Risk Mitigation Strategies outside the IIA Sphere

9.1 Adequate Contractual Risk Allocation in a Post-IIA Era

IIAs provide a useful framework for the protection of rights, but IIAs are not the only instruments through which such protections can be extended to international investors. During the growth era for IIAs and whilst globalism and international interdependence were the reigning political and economic theories, investors were well advised to utilise whatever IIA may have been available from the host nation to support and protect the investment. This could have included incorporating a project company in a different jurisdiction that had an IIA with the host state, so as to secure the rights and protections that may not have existed if there was no IIA between the host state and the home jurisdiction of the investor.

If it is accepted that the 'golden era' of IIA executions and compliance may have come to an end, international investors still seeking infrastructure projects in LDCs need to consider how to alternatively structure their transactions and to manage the risks that may previously have been ignored on account of the presumed protection of IIAs. There are two major avenues available to international investors to do this, being effective contract drafting and political risks insurance.

In drafting and negotiating a concession agreement or investment contract, the investor should seek a reasonable and balanced ‘stabilisation’ clause, which involves a commitment from the host state not to alter the regulatory framework governing the project, by legislation or other means, outside specific circumstances (such as with the

95 Dan Ciuriak, Policy Brief, *'Renegotiating NAFTA: Implications for Canada of Possible Trump Administration Policies,'* 9 March 2017 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2911390 > accessed on 22 January 2018

96 Sergey Ripinski, '*Venezuela's withdrawal from ISCID: What it does and does not achieve,'* International Institute for Sustainable Development, 13 April 20132, < https://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve/ > accessed on 19 January 2018

97 Above, n 96

consent of the international party, for the restoration of economic equilibrium or with the payment of adequate compensation).[98] The critical balance to be struck with a stabilisation clause is to provide sufficient regulatory protection to the international investor without unreasonably constraining the host state's ability to legislate and manage the country (and thereby potentially sewing the seeds for a subsequent expropriation). Stabilisation clauses have been analysed in investor arbitrations and found to be legal and binding, and should be utilised as an additional protection measure.

Additionally, in circumstances where the investor considers there is a genuine risk of expropriation and can undertake sufficiently robust financial modelling to demonstrate the damages it would require to be adequately compensated for expropriation, the international investor may wish to include an express contractual right for the host state to expropriate, subject to the payment of contractual damages based on the investor's determination of the relief required to be made whole. Such a clause and damages structure may be considered a 'buy-out' mechanism, and may provide the investor with the protection of effectively liquidated damages in the event of an action akin to expropriation. If this provision was teamed with a foreign governing law clause, such as English law, international arbitration before a 3 member tribunal, seated in a neutral country with a robust domestic legal system supporting international arbitration as the dispute resolution provision and a contractual waiver of sovereign immunity by the host state (extending to a waiver of sovereign immunity in the enforcement of an arbitral award), the international participant may be comfortable with the remedies to which they will become entitled in a 'worst case' scenario and the process available to secure those remedies.

By direct negotiating the fair and reasonable protections expected by the international investor against the host state, and including these in the underlying contract for the project, there should be a stronger moral obligation and direct commitment by both parties. If the dispute resolution mechanisms are sufficiently robust to allow the international investor to pursue their contractual entitlements and obtain a fair and independent arbitral award, and to enforce that award against the host state, the international investor will enjoy many of the similar protections that it would expect, or have expected, under an IIA. It is largely within the power of the contracting counterparties to extend similar protections, even if the willingness to continue to stand by IIAs is declining.

9.2 Political Risks Insurance

Finally, international investors can and should pursue protections outside of the contract. Specifically, international investors and contractors should procure adequate political risk insurance ('PRI'). The extent of protection available under a PRI policy depends of course on the terms of the policy, but PRI can supplement any existing protections under an applicable IIA or the concession agreement by indemnifying the insured against certain actions taken by the host government.[99] Although not all risks can be covered or managed in a cost effective manner through PRI, where the underlying concession agreement addresses some but not all of the sovereign risk issues, a targeted PRI policy could be negotiated and purchased to fill the gaps in the coverage.[100]

Irrespective of the future of IIAs, international contractors and financiers are able to manage the main issues and protections from an IIA through the specific terms of the contract or concession agreement to be entered into, and through PRI, so as to establish a suitable risk position that can be accepted to justify pursuing the opportunities available in the developing world infrastructure market.

10. Conclusion

All investments and construction projects are subject to political risk: the possibility that, after investments have been sunk and costs incurred, governments will enact policies that reduce payoffs to investors.[101] Political risk is particularly severe in the case of foreign investments and projects, where the absence of supranational courts limit legal remedies and where an investor's foreign nationality limits redress through domestic political institutions.[102] Further, political risks increase over time,[103] and remain as prevalent today as ever in developing markets.[104] Accordingly, long term infrastructure projects in developing markets expose international

[98] Lorenzo Cotula, 'Regulatory Takings, Stabilization Clauses and Sustainable Development' (Paper presented at the OECD Global Forum on International Investment VII, Paris 27-28 March 2008), 5.

[99] Ginsburg, above n 13, 946.

[100] Ibid

[101] Michael Tomz and Mark Wright, 'Sovereign Theft: Theory and Evidence about Sovereign Default and Expropriation' in William Hogan and Federico Sturzenegger (eds), *The Natural Resources Trap: Private Investment without Public Commitments* (MIT Press, 2010) 69, 69.

[102] Ibid.

[103] Ginsburg, above n 13, 948.

[104] Ian Bremmer, *Top Risks of 2013,* Eurasia Group 2013 < https://s3.amazonaws.com/Top_Risks_2013/Top+Risks+2013.pdf>

participants to appreciable political risks.

IIA have at times been considered the silver bullet in respect of political risks management and mitigation, however their actual effectiveness can be disputed. Further, whilst the 1990s and early 2000s provided the 'golden age' for IIAs, we are now seeing a new zeitgeist where the previous political and economic theory of globalisation, expanding international trade and commerce, and open doors is being replaced with more domestically focussed, self interested, and xenophobic policies and rhetoric, particularly from some of the main capital exporting nations such as the USA, England and Western Europe. In this era, it cannot be assumed that IIAs will continue to be entered into or continue to be respected, particularly in circumstances where the host government may face increasing 'anti-international' pressure. It may be, then, that IIA do not mitigate sovereign risk as effectively as they may have done in the 1990s and 2000s. Whether or not that matters, depends on the alternative steps that are taken by international investors to address sovereign risk, outside of the IIA landscape. If international investors negotiate protections into the concession agreements or contracts being signed, and are comfortable that the drafted provisions extend adequate protections and will be valid and enforceable, the international investors and contractors may enjoy similar overall protection as would be the case under an IIA.

Strategies that need to be pursued outside the IIA realm include negotiating fulsome and adequate contractual terms, that include stabilisation provisions and drafting to address risk of expropriation and compensation for expropriation, as well as independent governing law and dispute resolution by way of international arbitration. International participants should then also procure appropriate political risks insurance policy to close any major, outstanding political risks.

By adopting a comprehensive approach to political risk, and not relying solely on IIAs, international investors will be well placed to pursue the significant volume of high value infrastructure development projects that will be required in the developing world over the coming decades, irrespective of how the political and international investment landscape may change. Political risk will always exist, and the golden era of IIAs may have come to an end, but that is no reason to run to the exits. Systems and strategies exist to facilitate the control and pricing of sovereign risk and if they are pursued in a considered manner, international participants can generate a risk position that is similar to that available under IIAs.