Resource Nationalism: A Return to the Bad Old Days?

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This article discusses the expropriation and nationalization by States of foreign-owned natural resource assets for strategic or nationalistic reasons (also known as resource nationalism), including the different methods they use to obtain control of, or derive more economic benefit from, these assets. This article also discusses the strategies foreign investors can use to minimize the risk of resource nationalism and the steps they can take to protect their investments after their assets have been expropriated or their ownership interests otherwise undermined.

In April 2012, Argentina announced the nationalization of most of Repsol YPF S.A.'s 57.4% stake in Argentina's biggest oil group, YPF. YPF's interests include rights to the valuable Vaca Muerta shale gas discovery. Repsol had purchased its stake in YPF in 1999 for $13 billion and Repsol will no doubt seek substantial compensation. But Argentina's actions raise several issues, including:

- Will Repsol get fair value for its investment?
- When will Repsol receive compensation for its loss?
- Who will determine and enforce Repsol's rights?

These questions are not unique to Repsol. They are questions that many foreign investors have or must consider as States continue to nationalize or expropriate foreign-owned assets.

The nationalization or expropriation of foreign-owned assets (and of rights relating to natural resources in particular) is not new. However, in recent years, there has been a marked increase in these actions as many governments in Latin America, Asia and Africa have sought a greater share of and more economic benefits from their natural resources and mineral wealth.

This article analyzes the issues and events that have precipitated these developments and what foreign investors can do to protect their interests before and after they invest in a foreign jurisdiction. In particular, this article:

- Explains what resource nationalism is and the industries in which it is most prevalent. Although this article focuses on the mining industry, it applies to extractive industries generally.
- Describes the methods that host governments use to gain more control of their natural resources.
- Discusses the strategies that foreign investors can use to minimize the risk of resource nationalism.
- Discusses foreign investors' rights and remedies following an act constituting resource nationalism.

WHAT IS RESOURCE NATIONALISM?

States can expropriate any type of asset or project within their territory. However, when they expropriate natural resources for strategic, nationalistic and economic reasons, it is usually referred to as resource nationalism. Although frequently influenced by ideology and domestic politics, resource nationalism is typically seen when a State thinks that a foreign investor is getting too good a deal for their investment, especially when prices for the natural resource rise beyond the levels originally anticipated. In these cases, the State may seek to impose new terms or regulations on the investment or the foreign investors to improve the position of the State.

Investment agreements in the extractive industry (mining and oil exploration) usually involve long-term concessions or mining licenses that provide for flat royalty and tax rates. These agreements are not well-designed to accommodate significant changes, such as the recent record commodity prices or evolving political, social or economic conditions. As a result, host governments often challenge these agreements as unfair or not sufficiently beneficial to the host country.

Resource nationalism is sometimes mistakenly seen as a purely developing world or emerging market phenomenon. Frequently, practitioners fail to define or qualify changes to the taxation regime or restrictions in foreign investments in developed economies as manifestations of resource nationalism, although they often are. For example:

- On March 19, 2012, the Australian parliament passed the Minerals Resource Rent Tax (MRRT) which, among other things, imposes a tax of 30% on iron ore and coal profits in excess of a certain amount. The MRRT became effective on

July 1, 2012. One of the stated objectives of this new legislation is to give Australia an appropriate return on its non-renewable resources.

- In 2011, the UK government proposed a windfall tax on North sea oil profits. This proposal was ultimately tempered by offers of tax relief and tax breaks following significant criticism from the business community.
- In November 2010, the Canadian government rejected BHP Billiton's offer to purchase Potash Corporation because it was not in Canada's interest.

Nationalization through legislation or government decree, such as Argentina's nationalization of Repsol's interest in YPF, constitutes direct expropriation. However, the State does not need to take the whole property for it to amount to expropriation. A State can require that the foreign investor divest a portion of its ownership interest by selling a certain percentage to the government, a government-owned entity or a local party. This requirement can have significantly wider impact on an investment than other methods of expropriation that fall short of outright nationalization because it raises questions of compensation, control, management and the confidentiality of trade secrets.

Expropriation can also be indirect or occur through a series of measures (known as creeping expropriation). For example, a State may:

- Increase the royalties, taxes or other payments foreign investors must make to the government. In the past two years, more than 20 countries have announced or implemented plans to increase the government's percentage of the profits from mining projects by increasing taxes or royalties. For examples of these plans, see *Resource Nationalism in Mining*.
- Terminate, suspend or cancel the licences or permits that foreign investors need to operate. For example, just two days before Argentina nationalized YPF, Mongolia suspended exploration and mining activity on certain licences owned by SouthGobi Sands LLC, a division of SouthGobi Resources Ltd. In these cases, the host government or applicable ministry may argue that the foreign investor still maintains its investment, even though the investment may have been rendered useless because operations cannot proceed without the suspended or cancelled license.
- Regulate the foreign investor or its operations by imposing new (and often expensive) regulations. These regulations may restrict the foreign investor's operations to such a degree that they substantially impair the value of the investment. Many believe the Russian government used alleged violations of environmental regulations to force foreign investors to sell a portion of their interests in the Sakhalin project.

When is Resource Nationalism Most Likely?

Resource nationalism is by no means a new phenomenon, as illustrated by the long history of oil company nationalizations and contract renegotiations in the oil-rich Middle East and North Africa (MENA). In the 1970s and 80s a number of countries in Latin America also nationalized several of their industries. With increased globalization, the need for foreign investment and the move toward privatization, there were fewer attempts to seize foreign-owned assets until the current resurgence of resource nationalism. In fact, many developing and emerging countries gave foreign investors very favorable and generous terms to attract and promote foreign investment and expertise.

In recent years, however, a significant number of countries have sought to seize greater control of their mineral wealth (see, for example, the recent high profile nationalizations in Argentina, Venezuela and Bolivia). The resurgent resource nationalism of the 21st century has wider political and social drivers in addition to the traditional economic ones that are usually focused on. These drivers include:

- Over-dependence on natural resources.
- Fast growing populations whose social, educational and health needs are not being satisfied.
- Evolving politics. A government that comes to power on a nationalist platform or that is more critical of foreign investment may be more likely to change the terms of foreign investment.
- The need for jobs.
- The lack of infrastructure and social services.
- Outdated or inappropriate laws.
- A lack of transparency in the licence and concession award process.
- Exploitative contracts. Some foreign investors have taken advantage of political instability, corruption or a kleptocratic state to negotiate terms that are often opposed by the population or a new government.
- High commodity prices and competition for a depleting supply of natural resources.

These factors can create pressure on a State to increase its "take" from its natural resources. However, States face a difficult dilemma of how to maximize their benefit from a finite resource while not scaring off investors. In many cases, the State does not have access to the funds or expertise to exploit and develop its natural resources and must rely on foreign investors to do so.

Nonetheless, the State may determine that expropriation may be its most politically expedient option, even if it is not the best long term solution to successfully developing their resources. As a result of the number of creeping and express expropriations in recent years-across a growing number of jurisdictions, resource nationalism has been identified as one of the key risks for investors in the natural resources sector (see *Business risks facing mining and metals 2011-2012, Ernst and Young*).

Resource Nationalism in Mining

Resource nationalism is relatively common in extractive industries generally and the mining sector in particular. Some manifestations of resource nationalism are more obvious than others. For example, Hugo Chavez nationalized the gold industry outright in Venezuela. But as discussed above, there are many other ways in which States can seek to obtain a "new deal" (see *What is Resource Nationalism?*).

Angola

In September 2011, Angola adopted a new mining code which provides that in consideration for granting mining rights to an operator, Angola is entitled to an ownership interest of at least 10% in the operator or of the minerals extracted.

Argentina

To slow capital flight that has been estimated at about $3 billion per month, in October 2011, the government ordered the repatriation of the export revenues of energy and mining companies.

Botswana

In September 2011, Botswana required London-based De Beers to relocate certain staff to Gaborone in return for extending the renegotiating period for its diamond sales agreement from five to ten years.

Brazil

Brazil has proposed a new mining code that is expected to, among other things, increase royalty rates and limit the number of licenses that companies with large operations can have. This code is expected to be adopted sometime in 2012.

Indonesia

In March 2012, Indonesia announced that foreign ownership of certain mines would, in due course, be capped at 49%. Foreign investors who hold interests in excess of this threshold have ten years from the start of production to reduce their interest to the permitted level. In addition, in May 2012, the Indonesian government announced a 20% tax on exports of unprocessed metals, including nickel and gold.

Mongolia

In September 2011, the Mongolian government sought to renegotiate its 2009 investment agreement with Ivanhoe Mines of Canada, the holder of 66% of the interests in Oyu Tolgoi, the largest undeveloped copper and gold mine in the world. As part of this renegotiation, the government sought to accelerate the date on which it can exercise its option to increase its 34% share in the project to 50%, which under the agreement cannot occur until 2040. The government also wanted to impose a "sliding-scale royalty" on the project. Ivanhoe and its shareholder Rio Tinto rejected all attempts at renegotiation and the Mongolian government has since reaffirmed the agreement.

Peru

Effective as of October 1, 2011, mining companies must pay more in taxes for their mining activities in the country. The new law distinguishes between companies that have negotiated stabilization clauses or agreements with the government and those that have not. Companies that do not have these provisions must pay royalties of 1% to 12% on operating profits. Before the new law, the rates ranged from 1% to 3% on net sales. These companies must also pay a "special tax" ranging from 2% to 8.4% of operating profit. By contrast, companies that have stabilization clauses must pay a "special contribution" of between 4% and 13.12% of operating profits. These changes are expected to generate $1.1 billion of additional annual payments to the government.

Republic of Guinea

A new mining code was adopted on September 9, 2011 granting Guinea the right to own up to 35% of the share capital of mining companies in Guinea. The composition of the 35% differs depending on the mineral in question. For example, in the case of iron ore, bauxite, gold and diamonds, this 35% is allocated as follows: a free carried interest of 15% and the right to acquire an additional 20% on a fully paid basis.

South Africa

In 2004, South Africa's South African Mineral and Petroleum Resources Development Act 2002 (MPRDA) went into effect. This legislation, together with the Broad-Based Socio-Economic Charter for the South African Mining and Minerals Industry and the Charter Scorecard and the Mining Titles Registration Act of 1967 require, among other things, that:

- 15% of mining companies' equity be owned by Historically Disadvantaged South Africans (HDSAs) by 2009.
- 26% of mining companies' equity (or its equivalent in production) be owned by HDSAs by 2014.

It has been reported that South Africa is considering legislation similar to Australia's MRRT legislation. But the government has also stated several times that nationalization is not its policy.

Zambia

In October 2011, the Zambian government announced plans to increase the country's interest in mining projects from 20% to 35%. This announcement follows the election in 2011 of Michael Sata, who promised to create jobs and extract more money from the mining industry.

Zimbabwe

As part of an indigenization policy, foreign-owned companies are required to transfer at least 51% of local operations to black investors. In early April 2012, the Zimbabwe Empowerment Minister announced that mining companies that had not to date transferred the requisite ownership percentage to locals were deemed to have made this transfer. It is not currently clear, however, what this means and how this deemed transfer will be implemented.

Timing of Resource Nationalism: What Does it Mean for Investors?

Many countries (ranging from the US and Canada to Russia, Saudi Arabia and China) impose restrictions on foreign ownership of some or all of their natural resources or strategic assets. When these restrictions are known in advance and are clear and transparent, foreign investors can factor them into their investment decisions. The real challenge and threat to foreign investors is where changes are made after significant investments have already been made, often despite earlier express promises of economic and fiscal stabilization. These changes may alter significantly the economic profile of the investment and the foreign investor's expected rate of return.

The risk of future changes in a climate of increased resource nationalism and the regulatory and legal uncertainty it fosters can act as a significant deterrent to investment. Among other things, resource nationalism may:

- Make foreign investors less willing to invest in the country.
- Cause foreign investors to reduce their exposure to the country.
- Make projects more difficult and more expensive to finance. Lenders may, for example, require:
  - higher yields to compensate them for the increased risk;
  - shorter maturities to minimize the duration of their exposure; and
  - political risk insurance (PRI) to mitigate against the risk of expropriation and other government actions.

To the extent that new mining codes (or other applicable legislation) seek to mandate greater local content for health care, education, employment and management, mining companies have often been willing to embrace these requirements as part of their wider corporate social responsibility initiatives and to help them develop better relationships with local governments and communities. Many larger mining companies recognize that actively promoting local skills, health care and employment is not just good for the host country, but also creates a virtuous circle of cost-effective local resource and local stakeholders supportive of foreign investment and who are loath to see the benefit of such investments threatened (see *Commercial Solutions*). However, aggressive mandatory targets for local content and jobs may not be easy to attain and less established or smaller mining companies may have little experience and even less capacity to implement programs to achieve these targets.

ANTICIPATING RESOURCE NATIONALISM: STRATEGIES FOR INVESTORS

Investor returns can be drastically impacted by occurrences of resource nationalism. As a result, foreign investors and their counsel should take care to structure and document their deals to minimize the risks and effects of resource nationalism. Mechanisms that can be used to minimize these risks include:

- Contractual remedies such as freezing clauses and adaptation clauses.
- Bilateral investment treaties (BITs).
- Political risk insurance.

Contractual Remedies

Implementing a mining project frequently requires large, up-front capital expenditure. However, investors entering into mining concessions face a dilemma: they must bind a sovereign entity (or its representative, such as a state-owned mining company) to an agreed commercial bargain, which may contravene the basic principle of public international law that States may not renounce their sovereign prerogatives (including changing their laws to meet the countries' objectives and needs).

However, it is a well-established principle of international law that a State's sovereignty does not excuse it from complying with its contractual obligations. In a key case addressing this issue, an arbitration panel found that "the recognition by international law of the right to nationalize is not sufficient ground to empower a State to disregard its commitments, because the same law also recognizes the power of a State to commit itself internationally, especially by accepting the inclusion of stabilization clauses in a contract entered with a foreign private party" (see *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic, Award, 53 ILR 389 (Jan. 19, 1977)*).

As a result, foreign investors have frequently sought to include in their agreements either stabilization clauses or adaptation clauses, sometimes separately and sometimes in combination.

Stabilization or Freezing Clauses

A contract stabilization (or "freezing") clause seeks to preserve the sanctity of the contract against the sovereign right to change the law. This can be done by obtaining the agreement of the State that the terms of such contract/concession will not be varied by any change in law and/or that the laws (such as some or all of fiscal, employment, social and environmental laws) with which the company will have to comply will be those in force at the date of such contract/concession. Such clauses preserve for the foreign investor a 'frozen' set of rights and obligations vis-a-vis the State from the date of the concession or investment agreement for an agreed period of time.

Typically, the less investment a country has been able to attract, the longer the period of freezing and the more generous the terms (for example, tax holidays) the State may be willing to offer. However, over time, circumstances and the investment risk profile can change significantly. This may be the result of a successful transition to democracy (for example in Mongolia and Liberia) or new investment opportunities in the country (such as the discovery of deep water oil and gas off the west coast of Africa). These changes increase a State's negotiating leverage and may cause them to disregard or wish to vary these clauses.

In a climate of resource nationalism (often promoted as a populist policy in the context of democratic elections) and high commodity prices, the ability of foreign investors (or mining investors, in particular) to resist changes to freezing provisions has often been limited. In addition, non-governmental organizations and human rights groups have criticized these clauses for, among other things, undermining a country's ability to enact social, environmental and educational initiatives that may promote development, decrease poverty, and match best environmental practices (see *Practice Note, Understanding Stabilization Clauses in International Investment Agreements: Criticisms of Stabilization Clauses (http://us.practicallaw.com/1-501-7863)*).

Adaptation Clauses

A contract adaptation clause seeks to preserve some degree of balance between the parties in the light of changing circumstances, giving one or both parties a right to seek a contractual adjustment to accommodate changing circumstances. These circumstances may be limited to certain criteria (for example, commodity prices or specific mining costs) or may be completely undefined. An adaptation clause may be express or implied by local law. An express adaptation clause seeks to create a contractual obligation on the State(for example, to negotiate in good faith) to conduct negotiations over changes to a concession rather than seeking to unilaterally impose them.

In other cases, the investment agreement may include an economic equilibrium clause that allows the economic terms of the agreement to be renegotiated to preserve the investors' original economic position despite any changes in law. In this case, the new law or regulation still applies. However, its impact on the investor may be mitigated. For example, the State may help the investor manage the costs of complying by:

- Indemnifying the foreign investor for all or a part of these costs.
- Phasing in changes to allow a period to adapt.
- Increasing the term of the agreement to enable the foreign investor to recoup the costs.
- Modifying the royalty rates or other payment arrangements to offset the costs.

Adaptation clauses do not require a freezing of the surrounding legal framework and as a result, they are more in the nature of a private law arrangement between the parties and are potentially less likely to be breached or criticized.

For examples of these clauses and the different ways in which compliance costs may be mitigated, see *Practice Note, Understanding Stabilization Clauses in International Investment Agreements: Examples of Economic Equilibrium Clauses (http://us.practicallaw.com/1-501-7863)*.

Other Contractual Provisions

Aside from the specific provisions discussed above, other key considerations when negotiating a mining concession include determining the governing law of the agreement and the mechanism and forum for resolving disputes. To make this determination, investors must analyze and understand the local law issues impacting a mining concession, including:

- Does the host State's law recognize the sanctity of contract?
- Does it have investment laws offering protections of the kind that may be found in a BIT?
- What are the procedures for enforcement?

In some cases, compensation for expropriation may be available as a matter of local law. In these cases, investors should understand as much as possible the circumstances in which compensation is payable and how it is defined (for example, whether it includes compensation for loss of profits). It is advisable, where possible, for investors to include compensation provisions or other protections directly in the contract with the State regardless of whether these protections are available as a matter of law.

Bilateral Investment Treaties (BITs)

The contractual provisions discussed above may be of assistance in the actual mining contract or concession with the host State or State entity. However, investors may also be able to protect their investment without requiring any new agreement from the host State by structuring their investment to take advantage of existing BITs. A BIT is a short agreement between two countries that provide for the mutual promotion and protection of investments made by investors of the two countries. In order to achieve this, BITs prescribe certain minimum standards. The formulation of these standards depends on the terms of the treaty. BITs often include the following standards of treatment:

- **No unlawful expropriation.** The host State must not expropriate investments of investors from the other contracting country unless it is done for a public purpose, is non-discriminatory, is in accordance with due process of law and "prompt, adequate and effective compensation" is paid.
- **Fair and equitable treatment.** The host State must not:
  - harm the investment by unreasonable or arbitrary conduct; or
  - act in a way which is not transparent or contrary to the reasonable expectations of the foreign investor.

  This provision allows foreign investors to make a claim if the government institutes measures that have unfairly harmed them or their investment but do not go as far as expropriation.
- **Full protection and security.** The host State must physically protect the investment.
- **Non-discrimination.** The host State must not act in a way that discriminates against investments of investors of the other contracting State.
- **National treatment.** The host State must grant investors the same treatment that is given to its nationals.
- **Most-favored-nation treatment.** The investor is entitled to treatment as favorable as that given to nationals of other States.
- **Comply with obligations.** Some BITs require the host State to comply with all its obligations entered into in relation to the investment, which may include all its contractual obligations.
- **Standard of compensation.** Treaties often require the host State to provide "prompt, adequate and effective compensation". If the BIT does not include a standard, the State must pay compensation according to customary international law which requires that the reparation "wipe out

all the consequences of the illegal act". In other words, it must take into account all financially assessable damage (see *Case Concerning the Factory at Chorzow (Germ. v. Pol.), 1928 Perm. Ct.Int'l.J. (ser. A) No. 17 (Sept. 13)*). Monetary compensation is generally assessed to be fair market value of the investment. If the affected property is a going concern, the tribunal often determines the net present value of the likely income stream (a discounted cash flow (DCF) valuation). The DCF valuation may be supported by other methods of valuation.

Most importantly for investors, BITs allow an investor to bring a claim in international arbitration against the host State, which frees the investor from having to bring proceedings in local courts. No separate arbitration agreement is required to be negotiated between the investor and the State, because the BIT is sufficient.

Where possible, investors should attempt to structure their investments through a company in a jurisdiction that has a BIT with the State where the investment is being made (being careful in each case to check that the relevant BIT has been ratified or enacted). This simple step can provide significant extra protection and comfort to investors, as they will have an independent procedure for seeking compensation from the host State in addition to any contractual protections they may have.

However, while foreign investors are permitted to engage in regulatory and legal restructuring to take advantage of benefits (for example, tax and the substantive law of the jurisdiction) afforded by these BITs, they cannot obtain the benefit by restructuring after the harmful measure has taken place, otherwise they may face claims of treaty shopping and "abuse of rights" (see *Practice Note, Political Risk Insurance: Is it Necessary?: Bilateral Investment Treaties (http://us.practicallaw.com/5-503-9151)*).

In addition to BITs, foreign investors may also be able to take advantage of multilateral treaties, such as the Energy Charter Treaty and North American Free Trade Agreement. These treaties provide similar protections and rights to investors as those provided in BITs.

Political Risk Insurance

Political risk insurance, which is written by a market comprising private insurers (including Lloyds of London as well as several major insurance companies), export credit agencies and the Multilateral Investment Guarantee Agency, provides insurance against what has become a well defined set of specific political risks, including:

- Expropriation.
- Currency restrictions.
- Political violence, war and civil war.
- Contract frustration or breach of contract (such as non-payment).

For more information on these and other risks that may be covered under a PRI policy, see *Practice Note, Political Risk Insurance: Is it Necessary?: Insurable Political Risks (http://us.practicallaw.com/5-503-9151)*.

The protection provided by a PRI policy may be narrower than that provided by a BIT. However, as PRI is a bilateral contract between insurer and insured, it provides more flexibility. It gives investors the opportunity, which is not present with a BIT, to negotiate and tailor the precise scope and terms of the insurance coverage. Although, also unlike a BIT, PRI comes at a price, in the form of a premium.

Therefore, when contemplating whether to obtain PRI, availability and pricing should be one of the first issues addressed. This varies from country to country and project to project and depends on the market's perception of the risks involved. For example, rates for expropriation cover in Egypt and other countries in the Middle East increased following the Arab spring. In addition, the market's capacity for coverage in particular regions is finite and where there is capacity, the cover available for any particular project may be limited to such a level that it provides only partial cover for larger projects.

Investors should also ensure the policy covers the risks to which the insured is actually exposed. As noted above, depending on the nature and location of the investment in question, these may be more subtle and complicated than the out-and-out expropriation of property. Paying substantial premiums on a policy which protects against the confiscation of assets is pointless if the risks to which the insured is really exposed is the risk of being penalized through discriminatory taxation or having a mining license revoked. Investors and their counsel must carefully review the standard policy wording and tailor it to the extent commercially possible to cover the risks to which the insured is realistically exposed.

For more information on these issues and other considerations investors and their counsel should take into account when negotiating a PRI policy, see *Article, What Lenders Need to Know About Political Risk Insurance (http://us.practicallaw.com/9-505-3828)*.

The effect of a PRI policy is to transfer political risk from the insured to the insurer. It is therefore not surprising that the insurer will attempt to include in its policy a range of terms to protect its interests by ensuring that it is:

- Able to monitor the risk in question.
- Kept informed of all relevant developments.
- Given the opportunity to become involved in and direct any efforts to avoid or minimize a loss or effect recoveries.

The terms requiring the above are often expressed as exclusions, conditions precedent to cover or as warranties (for example, that any failure to comply will entitle the insurer to avoid the particular claim in question or to avoid any liability under the policy). It is, therefore, essential for an insured to:

- Familiarize itself with the policy terms.
- Understand the obligations imposed on the insured.
- Put appropriate procedures in place to ensure compliance with these terms.

(See *Articles, What Lenders Need to Know About Political Risk Insurance: Conditions for Compensation (http://us.practicallaw.com/9-505-3828)* and *Issues to Consider When Submitting a Claim Under a Political Risk Insurance Policy (http://us.practicallaw.com/0-505-3583).*)

Insurance can play a valuable role in mitigating political risk but it is only going to do so if handled with care and treated as a bespoke product, designed to address the risk profile of a particular project or investment.

Commercial Solutions

Investors in the natural resources sector are more aware than ever of the importance of local engagement and maintaining a good relationship with the government and the local communities. Where good relations have been fostered with host governments, this can give investors more flexibility to negotiate the terms of any new requirements affecting the investment. Investors may be able to preempt or contribute to changes.

One recent example of this is the Oyu Tolgoi copper project in Mongolia, where investors successfully negotiated with the host government for it not to accelerate the period for increasing Mongolia's stake in the mine (see *Mongolia*). Recently investors have had to become much more mindful of the importance of good public relations. In the current climate it is more important than ever for investors to be able to communicate effectively to the local community about the contributions they are making and the benefits their investment is bringing to the host country and its citizens.

STEPS FOLLOWING A RESOURCE NATIONALISM EVENT

Once a foreign investor has lost ownership of its assets or investment or has had that asset or investment devalued, it must consider the rights and the remedies that are available to it under:

- The terms of its agreement, if it has one. If the State or its entity is not a party or involved in the investment there may not be contractual terms directly relating to the actions that have been taken.
- Any applicable BIT or multilateral treaty.
- Any PRI policies it may have obtained.

Contractual Claims

Where applicable, the foreign investor must consider whether there has been a breach of contract. For example, an investor should consider whether the State or a State entity took an action in violation of the terms of the applicable concession, license or investment agreement, including any stabilization or adaptation clauses that the parties may have negotiated. Foreign investors should also be aware of the procedural steps they must follow to bring a claim against the State or its entity and to recover on any judgment rendered.

As previously discussed, to the extent possible, foreign investors should negotiate arbitration or adjudication in a neutral forum. If that was not possible and the investor's agreement with the host government provides for adjudication in the host State, local counsel should have advised the investor of the steps it should take to enforce its rights under the agreement prior to execution. Some of these steps may include:

- Translating the agreement into the local language.
- Notarization or apostilization of any relevant documents.
- Filing or recording the agreement with the appropriate filing office or ministry.

For more information on these requirements, see *Practice Note, Loan Agreement: Cross-border Provisions (http://us.practicallaw.com/9-502-4765)* and *Standard Clauses, Loan Agreement: Cross-border Provisions (http://us.practicallaw.com/5-383-3138)*.

Before initiating a claim, an investor should carefully consider its goals. If the investor wants to retain its investment in the host country and maintain a continuing relationship with the relevant host government or counterparties, the pursuit of any legal claim must be considered as part of a broader strategy that advances or supports this goal.

BIT Claims

To commence an arbitration proceeding under a BIT, the investor must show that it is a national of a State that is party to a given BIT and that it has made an investment in the State that is also party to that BIT. Before a claim can be initiated, most treaties generally require a notice of dispute to be served and then prescribe a "cooling off" period of between three and 12 months. During this time the parties are encouraged to have discussions before a formal request for arbitration is served under the BIT.

The BIT will usually provide for more than one form of arbitration, giving the foreign investor the right to choose which form of arbitration to pursue. BITs often include arbitration under the rules of:

- The International Centre for the Settlement of Investment Disputes (ICSID).
- The United Nations Commission on International Trade Law (UNCITRAL).
- One of the arbitral institutions such as the International Chamber of Commerce (ICC) or the Stockholm Chamber of Commerce (SCC).

ICSID arbitration may be invoked if the State of the investor and the host State are both parties to the ICSID Convention. Typically an ICSID arbitration may take two to three years before a final award is issued. The investor may be compensated for losses it suffers because of this delay by using a valuation of the loss at the date of the award or an award of interest from the date of expropriation. In any event, interest is usually awarded from the date of the award until payment of any damages award. An investor who is successful in its expropriation claim is often also awarded a substantial amount of the costs it incurred in pursuing the arbitration.

Enforcement of a BIT arbitral award

Although arbitral awards against a State can potentially be enforced against assets outside of the State in question, it may be problematic, particularly if it is necessary to find assets that are not protected by sovereign immunity. If suitable assets can be found, investors may have considerable leverage in an arbitration proceeding against the State. For example, in 2008, ExxonMobil Corporation obtained court orders freezing more than $12 billion in worldwide assets of PDVSA, Venezuela's state-owned oil company, to ensure funds would be available in case it was successful in its nationalization case against PDVSA.

However, a failure by a State to pay an award also reinforces the status of an expropriating entity as being especially high risk for investors. For example, in the case of Argentina, its return back to the international capital markets has been impeded by the fear that any proceeds raised can be caught up in claims from investors holding debt on which Argentina defaulted in 2001/2002.

Where it may be difficult to initiate an arbitration claim or to recover on an arbitral award, the investor may submit a claim under a PRI policy.

Claims Under a PRI Policy

If an investor has taken out PRI, one of the first things it must do if there is any actual or threatened act of resource nationalism is talk to the insurer. Generally PRI policies require the insured to:

- Notify the insurer of acts of expropriation and other insurable events.
- Exercise due diligence to minimize loss.
- Obtain the insurer's consent before agreeing on any loss.

Not keeping the insurer informed of what is happening is the most common source of disputes between insured and insurer and can easily invalidate a claim.

Investors must also understand what the policy provides in terms of the procedure for a claim. A policy may provide that the insured is obliged to exhaust all its legal claims before it can seek an insurance pay-out. The insured may be obliged to prove expropriation (meaning obtaining a judgment) before it can claim under the PRI policy. There may also be a waiting period, typically around 180 days, before the policy pays out. The precise terms vary from policy to policy and may be negotiated up front. It is imperative, therefore, for investors to understand the process before agreeing to the policy, not least so that they can follow the correct procedure in the event of having a claim.

Investors should also be aware of the insurer's rights of subrogation. In the event that an insurer does pay out under a policy, the insurer is entitled to step into the shoes of the insured and use its name to pursue compensation from the host government. In addition, the insured still has continuing obligations to assist with that process. So it is not necessarily a simple matter of making the claim, receiving payment and then forgetting about it.

For more information on submitting PRI claims, see *Article, Issues to Consider When Submitting a Claim Under a Political Risk Insurance Policy: Causation Issues (http://us.practicallaw.com/0-505-3583)*, *Waiting Periods (http://us.practicallaw.com/0-505-3583)* and *Pre-Existing Restrictions and Exclusions (http://us.practicallaw.com/0-505-3583)*.

AN OUNCE OF PREVENTION

No one approach to protecting an investment against the potential effects of resource nationalism provides a perfect solution in all circumstances. As is to be expected, a combination of contractual provisions, informed deal structuring and active management of political risk will provide the best chance of minimizing the risks of future resource nationalism, and should it arise, its impact. Engaging early and regularly with the host State and being able to demonstrate tangible benefits, such as improved health care and employment, to local communities is something that investors must increasingly focus on. Although remedies may be available to foreign investors following an act of resource nationalism, these remedies are often incomplete. PRI may not compensate foreign investors for all their losses (even assuming the investor can satisfy the conditions for compensation under the policy). In addition, investors may not be able to recover on an arbitral award in a timely manner or at all. As a result, the best course for foreign investors may ultimately be:

- To preempt resource nationalism through detailed discussion with relevant stakeholders.
- A willingness to make acceptable adjustments where the balance of benefits shifts unsustainably out of equilibrium.
- To work to ensure any changes of law are appropriate and certain.

There are ways of protecting against resource nationalism but in the end prevention may be better than the available cures.

For more information on Project Finance, search for the following resources on our website.

Practice Notes

- Expropriation in international investment law Expropriation in international investment law (http://us.practicallaw.com/5-384-7442)
- Political Risk Insurance: Is it Necessary? Political Risk Insurance: Is it Necessary? (http://us.practicallaw.com/5-503-9151)
- Understanding Stabilization Clauses in International Investment Agreements Understanding Stabilization Clauses in International Investment Agreements (http://us.practicallaw.com/1-501-7863)

Articles: know-how

- Bilateral investment treaties: an opportunity to reduce risk? Bilateral investment treaties: an opportunity to reduce risk? (http://us.practicallaw.com/0-202-0416)
- Issues to Consider When Submitting a Claim Under a Political Risk Insurance Policy Issues to Consider When Submitting a Claim Under a Political Risk Insurance Policy (http://us.practicallaw.com/0-505-3583)
- What Lenders Need to Know About Political Risk Insurance What Lenders Need to Know About Political Risk Insurance (http://us.practicallaw.com/9-505-3828)

